35th Annual Report

of the

SECURITIES AND EXCHANGE COMMISSION

For the Fiscal Year Ended June 30th, 1969

SECURITIES AND EXCHANGE COMMISSION

Headquarters Office
500 North Capitol Street
Washington, D.C. 20549

COMMISSIONERS

HAMER H. BUDGE, Chairman
HUGH F. OWENS
RICHARD B. SMITH
JAMES J. NEEDHAM
A. SYDNEY HERLONG, JR.

ORVAL L. DuBOIS, Secretary

LETTER OF TRANSMITTAL

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C.

SIR : On behalf of the Securities and Exchange Commission, I have the honor to transmit to you the Thirty -- Fifth Annual Report of the Commission covering the fiscal year July 1, 1968 to June 30, 1969, 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,

HAMER H. BUDGE, Chairman

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

COMMISSIONERS AND PRINCIPAL STAFF OFFICERS
(As of December 1, 1969)

Commissioners

HAMER H. BUDGE of Idaho, Chairman -- Term expires June 5, 1974

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

RICHARD B. SMITH of New York -- Term expires June 5, 1972

JAMES J. NEEDHAM of New York -- Term expires June 5, 1973

A. SYDNEY HERLONG, Jr. of Florida -- Term expires June 5, 1971

Secretary: ORVAL L. DuBOIS
Executive Assistant to the Chairman: TIMOTHY G. GREENE

Principal Staff Officers

CHARLES E. SHREVE, Director, Division of Corporation Finance.
THOMAS N. HOLLOWAY, Associate Director.
RALPH C. HOOKER, Associate Director.

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

IRVING M. POLLACK, Director, Division of Trading and Markets.
SHELDON RAPPAPORT, Associate Director.
STANLEY SPORKIN, Associate Director.

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

ANDREW BARR, Chief Accountant.
A. CLARENCE SAMPSON, JR., Associate Chief Accountant.

GENE L. FINN, 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. -- Kevin Thomas Duffy, 26 Federal Plaza, New York, New York 10007

Region 2. Massachusetts, Connecticut, Rhode Island, Vermont, New Hampshire, Maine. -- Edward P. Delaney, Acting, Suite 2203, John F. Kennedy Federal Bldg., Government Center, Boston, Mass. 02203

Region 3. Tennessee, Virgin Islands, Puerto Rico, North Carolina, South Carolina, Georgia, Alabama, Mississippi, Florida, that part of Louisiana lying east of the Atchafalaya River. -- Jule B. Greene, Suite 138, 1371 Peachtree Street, N.E., Atlanta, Georgia 30309

Region 4. Illinois, Indiana, Iowa, Kansas City (Kansas), Kentucky, Michigan, Minnesota, Missouri, Ohio, Wisconsin. -- John I. Mayer, Room 1708, U.S. Courthouse and Federal Office Bldg., 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, Fort Worth, Texas 76102

Region 6. Wyoming, Colorado, New Mexico, Nebraska, North Dakota, South Dakota, Utah. -- Donald J. Stocking, 7224 Federal Bldg., 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 Bldg., Seattle, Washington 98104.

Region 9. Pennsylvania, Maryland, Virginia, West Virginia, Delaware, District of Columbia. -- Alexander J. Brown, Jr., Room 532, Crystal Mall No. -- 2 Bldg., 1921 Jefferson Highway, P.O. Box 2247, Arlington, Va. 22202.

Branch Offices

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

Detroit, Michigan 48226. -- 230 Federal Bldg.

Houston, Texas 77022. -- Room 2606 Federal Office & Courts Bldg., 515 Rusk Ave.

Los Angeles, California 90012. -- Room 1043, U.S. Courthouse, 312 North Spring Street.

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

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

Salt Lake City, Utah 84111. -- Room 6004, Federal Bldg., 125 South State Street.

COMMISSIONERS

Hamer H. Budge, Chairman

Chairman Budge was born in Pocatello, Idaho, on November 21, 1910. He attended the College of Idaho, Caldwell, Idaho, and 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 Commission on July 8, 1964, for the term expiring June 5, 1969, and was reap -- pointed for the term expiring June 5, 1974. He was designated Chairman of the Commission on February 22, 1969.

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.

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 and an LL.B degree in 1953 from the University of Pennsylvania, where he was a Law Review editor. 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 TV. R. Grace & Co. in 1956 -- 57, until his appointment to the Commission, having become a partner of the firm in 1963. Commissioner Smith is a member of The Association of the Bar of the City of New York (Chairman, Committee on Aeronautics, 1963 -- 66), the New York State Bar Association, the American Bar Association and the American Law Institute. 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.

James J. Needham

Commissioner Needham was born in Woodhaven, New York, on August 18, 1926. He received a B.B.A. in 1951 from St. John's University. During

1944^6, he was in the Naval V -- 5 Program at Cornell University. At the time of his appointment to the Commission, Commissioner Needham, a Certified Public Accountant, was associated with A. M. Pullen & Company, based in Greensboro, North Carolina, serving as partner in charge of its New York office, and as a member of the firm's Executive Committee. Previously, he was associated with Raymond T. Hyer & Company and with Price, Waterhouse & Co. Commissioner Needham has been active in professional and business organizations, including the American Institute of Certified Public Accountants (as a member of Council); the New York State Society of Certified Public Accountants (including service as Treasurer and as a member of its Board of Directors and Executive Committee); the New York Chamber of Commerce; and the Accountants Club of America, Inc. He also has participated actively in many community organizations. Prior to assuming office on July 10, 1969, for the term expiring June 5, 1973, he resided in Plainview, New York.

A. Sydney Herlong, Jr.

Commissioner Herlong was born in Manistee, Alabama, on February 14, 1909, and in 1912 moved to Sumter County, Florida, and later to Lake County, Florida, where he attended public schools. He received an LL. B. degree from the University of Florida, Gainesville, Florida, in 1930, and commenced practicing law in his home town of Leesburg, Florida. Commissioner Herlong continued practicing law until 1937 when he was elected County Judge of Lake County, Florida. In 1948 he was elected to the U.S. House of Representatives and continually served in that body until January 1969, when he voluntarily retired. While serving in Congress, Mr. Herlong was a member of the Post Office and Civil Service Committee, the Agriculture Committee and, for the last seven terms, the Ways and Means Committee. Upon retirement from Congress, he became a consultant to the Association of Southeastern Railroads. He is a past president of the Florida County Judges Association, the University of Florida Alumni Association and the Florida State Baseball League. Mr. Herlong received the Good Government award from the Florida Junior Chamber of Commerce and the Distinguished Alumni Award from the University of Florida. He took office as a member of the Securities and Exchange Commission on October 29, 1969, for the term of office expiring June 5, 1971.

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"Back Office" Problems

One of the most serious problems facing the securities industry, the investing public and the Commission today is the "back office" or "paper work" problem. Its chief cause was the unprecedented rise in share trading volume. Since 1965 the combined annual volume of the New York Stock Exchange and American Stock Exchange has increased from 2.1 to 4.4 billion shares. The increase with respect to peak periods is even more dramatic. In 1962 the New York Stock Exchange was experiencing an average daily volume of 3.8 million shares, and it was projected that volume would double by 1975. Instead, volume almost quadrupled by December of

1968, during which month the Exchange averaged 14.9 million shares daily. By hindsight, it seems that the industry took longer than it should have to regard the progressively higher levels of activity as a new norm and to recognize that such levels of activity would require fundamental changes. Because of the prevalent tendency to view the increased trading as a temporary phenomenon, for a long time the reaction of many firms was to attempt to meet the new demand by more intensive use of their existing facilities. And, of the firms which attempted to meet the challenge by automating, some selected computer systems which had not been adequately tested and which they did not have the personnel to utilize effectively. Some firms survived the crisis only by reducing their operations to manageable size, while others remain only as parts of larger firms which acquired them.

One method of measuring the magnitude of the operational difficulties encountered throughout the securities industry is by statistics regarding the number of complaints against broker-dealers received by the Commission from members of the public. The Commission has always paid close attention to letters from individual investors, both because it feels a responsibility to protect public stockholders and because an analysis of complaints may give the Commission insight into previously unnoticed problems being experienced by a particular firm or by the industry in general. In. fiscal year 1969, however, the Commission was so inundated with complaints that at times it was unable to make a prompt reply to a complainant, much less an investigation of his charges.

Total complaints to the Commission against broker-dealers jumped from 3,991 in fiscal 1968 to 12,494 in fiscal 1969. This increase is all the more significant in light of the fact, which the Commission has learned from inspections of broker-dealer records, that for every letter of complaint sent to the Commission, 20 others are handled directly by the broker-dealer. Nine out of every 10 complaints currently filed relate to back office matters, particularly the failure to deliver customers' funds and securities, and virtually the entire increase in complaints this past year can be attributed to such matters. Although many firms with a large number of public customers came in for criticism, one firm alone accounted for a 10th of the complaints. The Commission has instituted proceedings against that firm and has cautioned many other firms about their duty to handle customers' accounts properly and service their complaints. The Commission is also encouraging the self-regulatory bodies to exercise closer supervision of their members with regard to the handling of customer complaints. It is a cause for concern that the number of complaints shows no signs of declining in fiscal 1970, but rather seems to be stabilizing at the rate of about 14,000 complaints a year.

Accompanying the trading volume peak in December 1968 was a record number of "fails to deliver" (securities contracts which a broker has not consummated by delivery of securities on settlement date). In that month, overdue contracts reached a total of $4.1 billion, an amount which presented serious risks both to brokerage firms and their customers. With an improvement in operational capabilities and a decline in trading volume during the last half of fiscal year 1969 came a decrease in fails to $2.2 billion. The improvement in this key statistic is somewhat encouraging, and the restrictions on trading hours have been eased so that at present trading on the exchanges and in the over-the-counter market is taking place 5 hours a day, 5 days a week. The Commission believes that through the joint efforts of the Commission and the industry more progress can be made in reducing the level of fails and in preventing fails from soaring with an increase in share volume. One measure taken by the Commission to assist in providing additional protections for the investing public was to amend its net capital rule to impose a graduated percentage deduction from market value of securities in the "failed to deliver" accounts of broker-dealers. By limiting the credit which firms can take for such securities as assets, the rule requires the firms either to make delivery of the securities or to reduce their aggregate indebtedness.

In dealing with the back-office problem, a nation-wide program of inspecting broker-dealers on an emergency basis was implemented by the Commission, the National Association of Securities Dealers, Inc. and the stock exchanges. This program singled out those firms experiencing the greatest difficulties. Various measures were taken during fiscal 1969 with respect to such firms, including warning letters, office conferences, restrictions on operations and the institution of 36 administrative proceedings and 14 injunctive actions. Because of the strain that back-office problems create on a firm's capital, in seven of the injunctive actions brought by the Commission receivers were appointed. The Commission has worked very closely with the self-regulatory organizations in this area to encourage and assist them in identifying troubled firms and taking appropriate corrective action. Where practicable the Commission coordinated its measures with those of the self-regulatory organizations.

The Commission has also encouraged and worked closely with the self-regulatory organizations and private groups in studying the problems and devising means to process efficiently the present and projected high levels of trading. The staff has met with groups to establish systems for the gathering and exchange of information on the financial and operating conditions of the brokerage industry. Several studies have been and are being conducted by private consultants retained by stock exchanges or other organizations to solve the back-office problem by modernizing the industry's operations through the use of systems logic and modern technology in the processing of securities transactions. The Commission and its staff have actively encouraged these studies and given of their time and effort to the extent possible. For example, one major recommendation has been to adopt a nation-wide system of clearing over-the-counter securities transactions so as to reduce the movement of the various papers and stock certificates. In furtherance of this proposal, the Commission sponsored a meeting in February 1969 at which representatives of the self-regulatory organizations, the banking industry, broker-dealers, the Commission and other government agencies discussed the proposal and reached certain basic agreements as to the nature and operation of such a system. Subsequent meetings on this matter have been held.

The Commission and its staff have also worked closely with the American Bankers Association, with regard to its attempts to utilize the capabilities of the computer with respect to the various forms used to process securities transactions. The ABA Committee on Uniform Security Identification Procedures has developed a uniform numbering system for the identification of all securities, and has also issued a report recommending the adoption of a man-machine-readable punch card size stock certificate. The Commission and its staff assisted in the studies that went into this report. A very auspicious development occurred in November 1969, when the New York and American Stock Exchanges endorsed in principle the machine-readable stock certificate and requested public comment on the Committee's report.

Despite the many unresolved operational problems which remained as fiscal year 1969 drew to a close, there were signs that the crisis was shifting from the operational to the financial area. Firms were increasingly experiencing difficulties in maintaining the required degree of liquidity, in part because of the additional expenditures necessary to reduce the paperwork logjam, and in part because of undercapitalization.

Automated Trading Information Systems

Advances in electronic data processing during the last few years have made possible the development of automated trading information systems for securities. These systems generally involve the use of tune-shared computers to transmit, among persons having access to them, indications of interest and, in some cases, firm offers and acceptances to purchase or sell securities. Consequently, such systems can be programmed to facilitate various steps in the process of trading securities, up to and including the actual execution of transactions.

During the 1969 fiscal year, plans for three automated systems for the trading of blocks of securities, two of them under private sponsorship and the third to be sponsored by the New York Stock Exchange, were announced to the industry. The systems are all designed to facilitate the bringing together of institutional buyers and sellers. There are, however, substantial differences between them. The proposed "Instinet" system is designed to permit direct dealing on an anonymous basis between institutions, without the intervention of brokers. The "AutEx" system, on the other hand, is geared more toward the use of brokers and existing exchanges. Only brokers would be allowed to enter into the system messages which disclose an interest to buy or sell, although institutional subscribers could enter general buying or selling preferences for particular securities. All negotiations would take place outside the system, and all executions would be effected either on an exchange or over-the-counter. The third system, known as the Block Automation System ("BAS"), is being developed by the New York Stock Exchange. As proposed, this system would be owned and controlled by the Exchange, only members of the Exchange would be allowed to subscribe for broker terminals, and entries would be limited to stocks listed on the Exchange. Institutions would also be able to enter indications of interest, but all negotiations would take place between member firms designated by the institutions.

In August 1969, the Commission released for comment proposed Rule 15c2-10 under the Securities Exchange Act of 1934, which would provide a regulatory framework for automated trading information systems that are not within the existing scope of regulation of exchanges and national securities associations. Any system for transmitting, among participants, subscribers or customers, indications of interest or offers to purchase or sell securities through the use of a computer would be covered by the rule unless specifically exempted. The rule would provide, among other things, that no broker or dealer may operate or participate in such an automated trading information system unless a plan describing the system, detailing specific rules of operation designed to prevent abuse of the system and providing for adequate recordkeeping, has been submitted to and declared effective by the Commission. The Commission could impose appropriate terms and conditions. The proposed rule would thus permit operators of the systems to develop flexible plans consistent with their own particular technologies and at the same time permit the Commission to make certain that such plans are consistent with its regulatory responsibilities. The Commission invited comments on both the regulatory status of the various systems and the specific terms of the proposed rule.

During the past fiscal year further progress was made in the development of an automated quotations system for the over-the-counter market to be known as the "NASDAQ System." On December 17, 1968, following adoption by the NASD of by-law amendments authorizing establishment of the NASDAQ System and of rules governing the operation of and access to the system, the NASD signed a 7-year contract with the Bunker-Ramo Corporation to build and operate the system. Presently scheduled to become operational in late 1970, the system envisions three levels of services capable of handling as many as 20,000 different over-the-counter issues. Initially it will provide instantaneous quotations on approximately 1,500 securities to offices of brokers, retail traders and market makers throughout the country.

Level I service will supply registered representatives of retail securities firms with immediate access to current representative bid and ask quotations on over-the-counter securities. Level II service will supply trading departments of securities firms and such other persons as the NASD's Board of Governors may authorize with actual current quotations of over-the-counter market makers for securities included in the system. Level III service is similar to that of Level II except that it will be available only to market makers registered with the NASD and will include input devices to enable market makers to insert their current quotations into the system.

The NASDAQ System will also furnish end-of-day reports to newspapers and wire services for publication in the daily stock tables. These reports will include volume figures and representative bid and ask quotations and net price changes for the securities in the system. The system will aid the NASD in its regulatory responsibilities by providing daily and other periodic summary reports of over-the-counter activity.

After it became apparent that the NASD would shortly enter into an operating contract, the Commission, in late 1968, adopted Rule 15AJ-2 under the Exchange Act which prescribes certain requirements applicable to a national association of securities dealers which establishes a system of quotations. These include the requirement that the applicable rules of the association incorporate as guides to interpretation and application certain public interest standards set forth in the Act, and also that such rules provide a fair procedure with respect to any refusal or limitation of access to such system by a customer, issuer, broker or dealer. The rule also provides for Commission review of adverse action by the association with respect to such matters. The Commission determined that the rules adopted by the NASD were consistent with Rule 15AJ-2 and other applicable requirements of the Act.

Structure and Level of Commission Rates

Under Section 19 (b) of the Securities Exchange Act of 1934, the Commission is responsible for determining the reasonableness of commission rates established by the exchanges for their members. Where necessary or appropriate for the protection of investors or to insure fair dealing in securities, the Commission, after notice and opportunity for hearing, may order an adjustment of such rates. In May 1968, the Commission moved to correct some of the inequities produced under the then existing rate schedule by requesting 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 by announcing that it would institute public hearings to give more extensive consideration to various aspects of the commission rate structures of the exchanges.

These hearings commenced in July 1968. Testimony and statements have been received from numerous interested persons and organizations including the New York, American, Midwest, Pacific Coast, and Philadelphia-Baltimore-Washington Stock Exchanges; the National Association of Securities Dealers; broker-dealers, including both exchange members and nonmembers; third market-makers; representatives of trade associations; and the Anti-Trust Division of the Department of Justice which, in addition to presenting its own comments, invited a number of independent economists to present their views.

In August 1968 the New York Stock Exchange submitted a proposal to amend its constitution and rules to provide for a reduction in intra-member commission rates and minimum commissions on trades involving more than 1,000 shares, and to prohibit the customer-directed "give-up." The Commission approved this proposal with the understanding that the changes were only acceptable on an interim basis pending the completion of the hearings and the development of long-term solutions to the various problems under consideration. The new schedules and prohibitions became effective December 5, 1968. The American Stock Exchange and all major regional exchanges effected similar interim adjustments of their rates coupled with prohibitions of customer-directed give-ups. It has been estimated by the New York Stock Exchange that, on the basis of 1967 trading volume, the new schedule will result in a yearly commission savings of approximately $150 million, or over $600,000 per trading day.

As a result of the Commission's inquiry, the New York Stock Exchange retained an economic consulting firm, National Economic Research Associates, Inc., to make a detailed economic analysis of the commission rate structure and to assist it in developing a new rate structure. NERA has indicated that it considers it necessary first to determine the proper level of commission income which member firms should receive for carrying out the brokerage function, and secondly to develop a rate structure which will yield that level and at the same time not discriminate unfairly among customers. It expects to make the necessary determinations through:

(1) a conceptual study of profit rates to determine the appropriate criteria for evaluating profit levels;

(2) a measurement of the capital invested in the industry;

(3) a comparison with profitability rates in other industries; and

(4) a measurement of profit earned in the securities commission business. The rate structure itself will be based on the costs associated with the execution of orders and the appropriate income level; an extensive transactions revenue study is being undertaken in order to determine such costs. It is anticipated that the entire study, including recommendations to the Exchange, will be completed by January 1970.

The American Stock Exchange has engaged the services of the Cambridge Research Institute to study and further develop the various approaches to commission rates which have been suggested during the hearings and to ascertain the impact of these approaches on those who will be affected. A report based on this study is expected to be ready for the Exchange in January 1970.

The Commission has not yet reached definite conclusions as to the many matters under inquiry in the hearings. The results of the studies described above will contribute to the body of information on which its determinations can be based.

Public Ownership of Securities of Exchange Members

The question of whether members of securities exchanges should be allowed to issue debt and equity securities to public investors has been studied by the Commission and the major exchanges for many years. Certain member firms have argued that in view of the need for capital of a permanent nature, the continuity of the firm, tax benefits which may be obtained, and the advantage of being able to attract outstanding management through stock option plans, they should be permitted to issue freely transferable subordinated debt securities and equity securities. Until recently, however, the rules of the New York and American Stock Exchanges have in effect prevented such public ownership.

As early as 1961, Merrill Lynch, Pierce, Fenner and Smith had proposed to the Few York Stock Exchange that member firms be permitted to issue equity securities to the public. At that time, the Exchange objected on the grounds that it might lose regulatory control over its members and that public ownership might be used by institutional and other investors to undermine the minimum commission rate structure. However, the proposal, though never actually acted upon by the Exchange, led to the appointment by the Board of Governors of a Public Ownership Committee in 1964 to study the entire question.

In November 1967, the Committee issued a final report recommending that members be permitted to issue debt securities to the public. The Exchange subsequently submitted this report to the Commission together with its endorsement of the Committee's position. The Commission raised certain questions concerning, among other things, the ratio of allowable debt to equity capital, the making of markets in these debt securities and applicable provisions of the Trust Indenture Act of 1939. The proposal was tabled by the Exchange until June 1969 at which time it was re-submitted in revised form. Though aware of the fact that for the most part the questions previously raised remained unanswered, the Board of Governors approved the necessary rule changes with the stipulation that the changes would not take effect until the details had been worked out with the Commission.

In May 1969, the New York Stock Exchange member firm of Donaldson, Lufkin and Jenrette, Inc., notified the Exchange's Board of Governors of its intention to issue its equity securities to the public, and it filed a registration statement covering a proposed offering of its common stock with the Commission. At the same time, it proposed changes in the Constitution and Rules of the Exchange which would permit the firm to retain its membership. In July the Exchange's Board of Governors endorsed the "concept" of public ownership of member firms. Prior to a vote by its members on the issue of public ownership, the Exchange submitted for Commission comment proposed amendments to its Constitution which would allow member firms to issue equity securities to the public. The Exchange also set forth 20 conditions which it intends, through these amendments and later rule changes, to impose on public ownership of member firms. The fact that the New York Stock Exchange accounts for approximately four-fifths of stock exchange trading volume underscores the importance of the policy considerations associated with its proposals to permit public ownership of member firms.

Since the Exchange proposals would have a significant impact not only on member firms, but on all broker-dealers, institutional investors, other exchanges and the public, the Commission considered that all interested persons should have an opportunity to comment on the proposed conditions, and it therefore invited the submission of views and comments. The Exchange has postponed its planned membership vote until such time as the Commission can comment on the Exchange's proposals.

Institutional Investor Study

Against the background of a very significant increase in recent years in the amount of securities held and traded by institutional investors, the Congress, by a joint resolution approved on July 29, 1968 (Public Law 90-438), authorized and directed the Commission to make a study and investigation of the purchase, sale, and holding of securities by institutions such as banks, insurance companies, mutual funds, employee pension and welfare funds, and foundation and college endowments in order to determine the effect of such purchases, sales, and holdings upon the maintenance of fair and orderly securities markets, the stability of such markets, the interests of the issuers of such securities, and the interests of the public. The Commission was directed to report to the Congress the results of its study and investigation, together with its recommendations. To fulfill these directives, the Commission constituted a study group of economists and lawyers, designated the Institutional Investor Study ("Study").

The Study's design has been divided into five sections. Three major sections deal with (1) the impacts of institutional investors on the securities markets and securities industry, (2) relationships between institutional investors and the companies whose securities are held in their portfolios and (3) the structures and investment operations of the institutions themselves. Two other sections deal with " (4) savings flows to institutions and their aggregate asset holdings and (5) continuing needs for the regular reporting of data about institutional investing.

1. Markets

As indicated in the authorizing legislation the Congress' first concern was with the impacts of institutional investors on the nation's securities markets. One major project will ascertain the extent and market impact of parallel trading by institutions (the buying or selling of the same security at the same time). In another project a number of individual position changes by institutions will receive detailed analysis to discover relationships between the size of the position change, characteristics of the security traded, the manner in which the position change is effected and the resulting market impact of that position change.

Institutionalization may affect not only the market prices of securities but also the structure of the securities markets and the securities industry that services them. Therefore, the extent to which and reasons why institutions use particular markets and services offered by the securities industry will be examined. Policy implications of the information developed in the markets section are among the most important of the entire Study.

2. Portfolio Companies

Public Law 90-438 expressly directs the Commission to assess relationships between institutional investors and the corporations whose securities they hold. Data will be compiled regarding concentrations of aggregate and individual stockholdings in particular portfolio companies, types of companies and industry groups. Institutional purchases and sales of portfolio companies' securities, the manner in which they vote or refrain from voting their holdings and their contacts with portfolio company managements will be examined. Representative transfers of corporate control will be analyzed, as they appear to constitute an avenue through which institutional investors may have a potentially important impact on the national economy. Data also will be gathered about institutional involvement with portfolio companies in less dramatic questions concerning dividend policy, financial structure and management compensation.

In response to Congressional interest the effects of institutional investment upon the financing of American business will be examined in this portion of the Study. Institutional preferences for different types' of securities, particularly debt versus equity, and the effects of these preferences upon both the ability of portfolio companies to obtain financing and the manner in which they do so, will be analyzed. In addition, the Study will analyze institutional participation in new issues of securities.

3. Institutions

The principal purpose of the institutions part of the Study is to understand the interior of the existing phenomenon of institutionalization. In this section of the Study, data are being gathered over various time periods about the internal organization of the different classes of investment management entities: the sizes and structures of the funds they manage, the existing legal environments within which they operate, the characteristics of the securities held in their portfolios (including their riskiness), their investment policies, trading activities and other determinants of either the growth or behavior of institutional investors.

The institutional part of the Study will look primarily at each of the various classes of institutional managers. Increasingly, however, lines between these classes have become blurred as institutions in one class expand into or become affiliated with institutions in another, and as institutional managers similarly expand into or are acquired by various portions of the securities industry. A special project will be devoted to analyzing the various forms these integrating trends appear to be taking and their effects on both market organizations and the provision of various financial services.

4. Flow of Funds

The Congress also has directed the Study to evaluate the impact of institutionalization on the amount and nature of savings in our economy and the allocation of the capital so generated. To ascertain savings flows to financial institutions and the net holdings into which they have been put, existing national balance sheet, income statement and flow of funds accounts are being extended to cover more detailed and meaningful institutional groups. An attempt also will be made to segregate asset growth into new money flows and investment return components.

5. Continuous Reporting

An objective of the Study will be recommendations for the reporting of information about institutional investing on a continuing basis. This is to prevent gaps in information, which in part led to the present Study, from necessitating one-shot data collection efforts in support of future studies. This portion of the Study surveys existing reporting patterns by institutional investors and securities firms with an eye toward determining how this information might better serve the needs of government statistical programs, regulatory bodies and public investors.

Public Law 90-438 specified September 1, 1969, as the Study's reporting date and authorized an appropriation of up to $875,000. As a result of delays in obtaining funds for operations in fiscal year 1969, and in forming a special staff drawn largely from outside the Commission, the Commission requested and was granted an extension of time until September 1, 1970, and permission to spend in fiscal year 1971 $70,000 which had not been expended in fiscal year 1969.

Reform of Laws Relating to Investment Companies

Efforts to obtain much-needed reform of the Investment Company Act of 1940 have continued in the 91st Congress. As described in the 34th Annual Report, legislation which would have implemented proposals of the Commission originally had been introduced in May 1967. The principal Commission proposals involved the reduction of sales loads imposed on the acquisition of fund shares where these loads are excessive, the elimination of the so-called "front-end load," and establishment of a means to test the fairness of management fees.

The proposals also dealt with a number of other areas which in the Commission's opinion required legislative action.

The Commission's proposals represented 10 years of effort by and on behalf of the Commission. In December 1966, the Commission had submitted a 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, S. 3724 (90th Cong.), on July 1, 1968 which, as amended, was passed by the Senate on July 26, 1968. However, no action was taken by the House Committee on Interstate and Foreign Commerce.

Early in the 91st Congress, Senator Sparkman introduced S. 34, which was the same as S. 3724, and hearings were held before the Senate Committee on Banking and Currency in April 1969. In May 1969, the Committee reported out, and the Senate passed, S. 2224 which was similar to S. 3724 in most major respects. This bill includes provisions reflecting Commission proposals with regard to so-called "performance fees" and oil and gas drilling funds. On June 10, 1969, Chairman Moss of the House Subcommittee on Commerce and Finance introduced an identical bill, H.R. 11995. That Subcommittee held hearings on this and related bills in November and December 1969.

In proposing mutual fund legislation in 1967, the Commission recognized that most of the specific abuses aimed at in the Investment Company Act had 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, and as a result these have been modified in the pending legislation, as described below.

Investment Advisory Fees. -- The Commission had recommended that the Act be amended to provide expressly that compensation received by investment advisers and other persons affiliated with investment companies shall be "reasonable" and that there be opportunity for judicial enforcement of this standard. This recommendation reflected the Commission's view that a requirement that compensation not be unreasonable was inherent in the fiduciary relationship existing between an investment company and its manager or adviser. The Commission also considered that the Federal courts would provide an appropriate forum in which the reasonableness of compensation could be tested.

The bill passed by the Senate in July 1968 substantially adopted these recommendations, with certain changes designed to meet some of the industry's objections. However, the industry, while not objecting to the concept that compensation should be reasonable, continued to oppose the form of the amendments. Following the April 1969 Senate hearings, the Commission and industry representatives resumed their discussions of this matter and in May 1969, agreed on and jointly submitted to the Senate Committee a substitute provision which specified that an investment adviser has a fiduciary duty with respect to such compensation. This is in accord with the Commission's recommendation that the presently applicable standards of "waste" and "gross abuse of trust" as applied to management fees be replaced with a more meaningful standard. The Senate Committee and the Senate adopted the management fee proposal in substantially the language proposed by the Commission and the industry representatives.

Thus, H.R. 11995 and S. 2224 add a new Section 36 (b) to the Investment Company Act to specify that the adviser has a fiduciary duty with respect to compensation for services or other payments paid by the fund or its shareholders to the adviser or to affiliated persons of the adviser. Other persons enumerated in Section 36 (a) who may have a similar fiduciary duty with respect to compensation or payments received by them from the fund or its shareholders may also be sued for breach of such duty in addition to liability imposed by Section 36 (a). Subsection (b) also provides that payments by the fund to affiliated persons of the adviser are subject to challenge under this section. Approval of the management fee by the directors, and shareholder ratification are to be given such consideration as the court deems appropriate in the circumstances.

Performance Fees. -- Performance-based fees are a specialized type of advisory compensation which has been used increasingly in recent years. The proposed legislation, in addition to subjecting such arrangements to the fiduciary standards of Section 36 (b), includes provisions specifically directed to performance-based fees. The Commission originally proposed that the prohibition of performance-based fees now applicable to advisers of private clients be extended to advisers of registered investment companies. However, after discussion with industry representatives, a modified provision, permitting a limited type of performance fee, was incorporated into the pending legislation. Under that provision, contracts which base any part of the adviser's fee on a specified percentage of the company's capital appreciation would be prohibited. On the other hand, fees which increase and decrease proportionately on the basis of investment performance measured against an appropriate index of securities prices or other appropriate measure of performance would be permissible. The "base" or "standard" fee would be permitted only at the point that the fund's performance equaled the index.

H.R. 11995 would also give the Commission authority to permit other performance fee arrangements by adding new Section 206A to the Investment Advisers Act, which would give the Commission authority to exempt any person or transaction from any provision of that Act to the extent necessary or appropriate in the public interest and consistent with the protection of investors.

Level 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 pending legislation would give authority to the National Association of Securities Dealers, Inc., a self-regulatory organization of brokers and dealers, to eliminate excessive sales charges, subject to Commission oversight.

The Front-End Load on Contractual Plans. -- The Commission had recommended the abolition of the so-called "front-end load" on periodic payment plan certificates (i.e., certificates issued in connection with contractual plans for the accumulation of fund shares on an installment basis), under which as much as 50 percent of the payments: made by the investor during the first year may now be deducted for sales charges. The bill, as passed by the Senate, permits a front-end load, if either of two alternative conditions are met. Under the first alternative periodic payment plan certificates could be sold with the presently authorized front-end load, provided that if the investor elects for any reason to redeem his certificate for cash during the first 3 years after its issuance he would be entitled to receive a refund of the difference between the total sales charges paid and 15 percent of such payments. The Commission would be authorized to adopt rules and regulations specifying the form of refund notice and setting forth reserve requirements so that sellers could meet their refund obligations. The other alternative would permit sellers of periodic payment plan certificates to charge a sales load which does not exceed 20 percent of any payment nor average more than 16 percent over the first 4 years.

The Front-End Load on Face-Amount Certificates. -- On August 27, 1969, the Commission submitted to the Senate Committee on Banking and Currency a "Report on Face-Amount Certificate Companies," the result of an in-depth study conducted at the request of the Committee. In this Report, the Commission reasserted the position taken in its 1966 report that the imposition of the front-end load on installment face-amount certificates (i.e., certificates which have a fixed ultimate value and a reduced rate of return if redeemed prior to maturity), is contrary to the public interest and the interest of investors, and recommended that such practice as well as the practice of imposing equivalent surrender charges be discontinued. A bill, H.R. 13754, which would implement the Commission's recommendation, was introduced in the House of Representatives on September 11, 1969.

The Commission's Report pointed out that during 1968 only four companies were issuing face-amount certificates and that one of those companies accounted for over 94 percent of the assets of all such companies. However, approximately 20,000 installment face-amount certificates were sold in the United States in that year, and investors made payments of over $5.7 million. At June 30, 1969, more than 370,000 such certificates were in force. The Report observed that a substantial percentage of investors lose money on their investment in face-amount certificates because of the deduction of a front-end load from early years' payments. On most of the certificates currently being sold, the investor does not break even on his investment until after the payments required in the first 8 years have been made. Of those persons who purchased the most popular face-amount certificate (a 20-year certificate sold by the dominant company) from 1945-1948, more than 55 percent surrendered their certificates prior to the breakeven point and therefore lost money. In October 1965, this company began issuing new series of certificates which had lower front-end loads, improved yields to maturity, and improved first-year and immediate minimum cash values; however, its new certificates have been surrendered at a loss by investors at approximately the same rate as the certificates previously sold.

The losses to investors are particularly significant since the median annual family income of purchasers of the leading company's certificates in 1968 was only $9,750. On the other hand, the total 1968 payments of $5.7 million represent only .0002 percent of the total volume of securities traded that year on the registered securities exchanges in the United States. On the basis of these and other comparative figures, the Commission concluded that the economic impact of its recommendation on the securities industry, if any, would be negligible.

The Commission found that the front-end load also tended to support a highly structured personal selling effort, with salesmen generally receiving the same commission for selling a face-amount certificate as for selling an equity investment in a mutual fund contractual plan requiring the same monthly payments. In addition, the investment yield on face-amount certificates, if held to maturity, was found to be less than that realized from comparable alternative savings programs. For investors who were in a constant 20, 30 or 40-percent tax bracket through the life of a 20-year certificate, the after-tax yield on the highest-yield certificate offered by the dominant company was no better than the median annual yield on U.S. Series E Savings Bonds, or on deposits in savings associations, mutual savings banks and commercial banks. Thus, if discontinuance of the front-end load should result in a less intensive sale of face-amount certificates, alternative accumulation programs with comparable after-tax benefits would still be available.

Oil and Gas Drilling Funds. -- The pending legislation would amend Section 3 (c) (11) of the Act to terminate the exclusion from the Act of those oil and gas funds which issue redeemable securities, or sell their securities on the installment plan. Oil and gas funds in which investors make only a single payment and do not receive a redeemable security would still be excluded from the definition of investment company.

The new provision would not become effective until 18 months after passage. The discussion on the floor of the Senate regarding S. 2224 makes it clear that it is intended that the Commission and oil and gas industry representatives confer during that interval to work out an equitable arrangement for regulation which would protect and safeguard investors and not impose an unreasonable burden on the industry.

Subsequent to the passage of S. 2224, the Commission staff conferred with representatives of the oil and gas industry. During hearings on S. 2224 before the House Subcommittee in December 1969, the Commission confirmed its original view that there is a need for regulation to some degree of the type provided in the Investment Company Act for this industry but that such regulation would appear to present certain real problems for the industry, primarily because of the difficulty of accommodating the industry structure contemplated by the Investment Company Act with the structure in fact adopted by this industry in order to provide favorable treatment for its investors under the Internal Revenue Code.

Therefore, the Commission stated to the House Subcommittee that if the Committee wishes to delete the oil and gas amendment from the 'bill, the Commission would not object. The Commission stated that it made this suggestion on the assumption that representatives of the oil and gas industry would cooperate with the Commission in working out a reasonable regulatory statute consistent with the protection of investors, for submission to Congress within 18 month after passage of the mutual fund legislation.

Study of "Hedge Funds"

In January 1969 the Commission commenced an investigatory study of so-called "hedge funds." These are generally private investment partnerships which employ speculative investment techniques with a view to rapid capital appreciation. The study also encompasses the activities of some 50 registered investment companies which engage in similar investment techniques.

During the last few years, there has been a rapid increase in the number and assets of hedge funds. It is estimated that the number of such funds is now approaching 200, with estimated total assets of about $1.5 billion. Most hedge funds are structured to avoid the need for registration as investment companies, relying on an exception provided by the Investment Company Act for an issuer whose outstanding securities are owned by not more than 100 persons and which is not making and does not presently propose to make a public offering of its securities.

Typically, hedge funds trade on margin, sell short and write or buy put and call options. The general partner of the fund, who is frequently an officer, partner or registered representative of a broker-dealer, or an investment adviser, is given the power to make portfolio decisions and effect transactions for the partnership. Because hedge funds are so strongly performance-oriented, they may have a greater impact on the securities markets than their asset size would indicate.

In order to obtain meaningful information concerning the organization and activities of hedge funds, about 200 nonregistered investment partnerships and 50 registered investment companies which engage in hedge fund trading techniques were requested to file comprehensive statements with the Commission. Analysis of the submissions should permit the Commission to determine what, if any, additional measures are necessary or appropriate for investor protection.

Report of the Disclosure Policy Study

At the end of 1967, a small group of Commission staff members began an over-all study of the disclosure process. Under the direction of former Commissioner Francis M. Wheat and working with representatives of the legal and accounting professions, the securities industry, and the general business community, the Study Group devoted about 15 months to the study which culminated in the submission to the Commission in March 1969 of a report entitled Disclosure to Investors -- A Reappraisal of Federal Administrative Policies Under the '33 and '34 Acts. That report constitutes an attempt to discover what could be done within the existing statutory framework to:

(a) enhance the degree of coordination between the disclosures required under the Securities Act of 1933 and the Securities Exchange Act of 1934;

(b) clarify the law of disclosure and make its application more certain;

(c) assure that appropriate disclosures are made prior to the creation of interstate trading markets in securities; and

(d) enhance the utility to investors and to those who advise them of the documents generated under the Federal securities statutes without imposing undue burdens on those who must prepare these documents.

The Report notes that disclosure is and has from the outset been central to national policy in the securities field. This emphasis on disclosure stems from two considerations. One relates to the proper function of the Federal Government in investment matters. Apart from the prevention of fraud and manipulation, this responsibility was viewed by the draftsmen of the statutes as being primarily one of seeing to it that investors and speculators have access to enough information to enable them to arrive at their own informed decisions. The other, less direct, rests on the belief that appropriate publicity tends to deter questionable practices and to elevate standards of business conduct.

The Report pointed out that the trading markets in outstanding securities involve much more money and far more people than does the distribution of securities being offered to the public for the first time. Thus the Report's emphasis is on continuous disclosure under the Securities Exchange Act.

Space limitations preclude any attempt to discuss or even to list the 61 specific recommendations made in the Report. However, a capsule summary of some of the Report's most significant conclusions and recommendations is set forth below:

(1.) Steps should be taken to assure that prospectuses are more readable. These should include:

(a) denying acceleration to registration statements the prospectus portions of which are unnecessarily long or complex; and

(b) requiring a "guide" to any prospectus whose text portion exceeds 10 pages.

(2.) Short-form prospectuses should be permitted in certain situations (e.g., secondary offerings on exchanges and offerings of stock to be issued on the exercise of publicly held warrants) in which conventional prospectuses are now required. However, the proposed short-form prospectus would be available only to issuers that make adequate continuous disclosures under the Securities Exchange Act.

(3.) The group of issuers permitted to make condensed Securities Act disclosures on the Commission's Form S-7 should be enlarged.

(4.) In first public offerings, preliminary prospectuses should be delivered to investors before the registration statement becomes effective. The Commission should use its discretionary power to accelerate (or refuse to accelerate) the effective date of Securities Act registration statements in order to achieve this objective.

(5.) The lines of demarcation between those offerings that must be registered under the Securities Act and those as to which such registration is not required should be made more precise. Present uncertainties stem largely from the traditional subjective criteria of investment intent and change of circumstances.

(6.) A distinction should be drawn between companies that file regular, informative reports on their affairs with the Commission ("reporting companies"), on the one hand, and those that do not file such reports ("nonreporting companies"), on the other.

(7.) The area in which this distinction would be most significant is that of the so-called "secondary" sale, i.e., a sale by a person who is not himself the issuer of the securities in question, but who is treated as though he were their issuer for purposes of the Securities Act's registration requirements. He may be so treated because he is a controlling person of the issuer or because he acts as a link in a chain of nonpublic transactions by which securities move from an issuer to the public. Present distinctions in the rules applicable to the two types of secondary sellers should be largely abandoned.

(8.) In the case of a reporting company, both the controlling person and the nonpublic purchaser should be permitted to resell -- without Securities Act registration -- in normal trading transactions. A valid general framework for differentiating normal trading transactions from those that do not fall within that category can be found in the Commission's present Rule 154.

(9.) However, the use of ostensible private purchasers as conduits for the sale of securities to the public must be prevented. To achieve this objective, a short mandatory holding period during which the private purchaser is at risk and precluded from reselling to the public is essential. The Report recommends one year for this purpose.

(10.) In the case of the nonreporting company, on the other hand, adequate investor protection requires that unregistered secondary sales be inhibited. Accordingly, registration (or in appropriate cases qualification under Regulation A) should be required whenever a controlling person of a nonreporting company makes an interstate public offering of its securities. The Report suggests that the holder of any security acquired "in a transaction or chain of transactions none of which was a public offering or other public disposition" be free to reoffer or resell it publicly after 5 years have elapsed from the date of its sale by the issuer or by a person in control of the issuer.

(11.) At present some-but only some-business combinations in which the acquiring corporation issues its own securities in payment are deemed to involve "offers" and "sales" for Securities Act purposes. When a combination is effected by means of a statutory merger or consolidation, the Securities Act's disclosure requirements are inapplicable because, under a long-standing Commission rule (Rule 133 under the Securities Act), the submission of an acquisition transaction to shareholders is deemed to involve neither a "sale" nor an "offer to sell." On the other hand, an offer of its securities by one company to the security holders of a second company which it wishes to acquire has always been regarded as involving both an "offer to sell" and a "sale." The Report would remove this distinction and provide a specialized registration form for those business combinations now covered by Rule 133.

(12.) Regulation A under the Securities Act should be amended so as to increase the quantities of securities salable thereunder by persons other than issuers.

(13.) The present Regulation A rule obviating any need to deliver an offering circular to public investors so long as the amount of securities sold in any one year does not exceed $50,000 should be abandoned.

(14.) In its present form continuous disclosure under the Securities Exchange Act is an inadequate substitute for the occasional but comprehensive disclosures produced under traditional Securities Act practice. This disparity should be narrowed by:

(a) rearranging the items in the initial disclosure document under the Exchange Act (Form 10) in the order of their importance.

(b) converting the issuer's annual report to the Commission (Form 10-K) into an annual updating of the material in the Form 10; and

(c) substituting a new quarterly report to the Commission (to be designated Form 10-Q) for present Forms 8-K and 9-K. The proposed quarterly report would be due 45 days after the close of each fiscal quarter (except that a report of a significant acquisition or disposition of assets would be due 10 days after the execution of a written agreement for such acquisition or disposition). This quarterly report would consist of two parts. The first would cover the substance of the present 8-K with a number of changes. The second would consist of condensed, comparative financial information.

In September and October 1969, the Commission invited public comments on a number of proposed new or revised rules and forms designed to implement or put into effect most of the recommendations of the Report.

Additional Financial Disclosure lay Diversified Companies

The increase in acquisitions and mergers in recent years has caused the Commission to consider the need for more detailed reporting on the 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 1968 important studies by professional organizations and by individuals on the topic of financial reporting by diversified companies were completed. The Commission had authorized its Chief Accountant to serve on an Advisory Committee, representing various sectors of the accounting financial and industrial communities, in connection with a 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 registrants. In September 1968, a proposal to revise the disclosure requirements in certain registration forms under the securities acts was issued for public comment.

The comments received on the proposals were considered in the formulation of revised proposals which were published for comment in February 1969.19 Definitive amendments to the registration forms were adopted by the Commission in July 1969.

The items of the forms to which the amendments relate call for a brief description of the business done and intended to be done by the registrant and its subsidiaries. The amendments require, where a registrant and its subsidiaries are engaged in more than one line of business, the disclosure for each of a maximum of the last 5 years subsequent to December 31, 1966, of the approximate amount or percentage of total sales and operating revenues and of contribution to income before income taxes and extraordinary items attributable to each line of business which contributed, during either of the last 2 fiscal years, a certain proportion to the total of sales and revenues, or to income before income taxes and extraordinary items. For companies with total sales and revenues of over $50 million the proportion is 10 percent and for smaller companies it is 15 percent. Similar disclosure is also required with respect to any line of business which resulted in a loss of 10 percent or more, or 15 percent or more for the smaller companies, of such income before deduction of losses. Where the percentage test as applied to both sales and earnings contributions results in more than 10 lines of business, the disclosure may be limited to the 10 most important lines of business. Where it is not practicable to state the contribution to income before income taxes and extraordinary items for any line of business, the contribution to the results of operations most closely approaching such income is to be disclosed.

The amendments continue the existing requirements on breakdown of total volume of sales and revenues by principal classes of similar products or services, except that the percentage test has been reduced from 15 to 10 percent in the case of companies having total sales and revenues in excess of $50 million during either of their last 2 fiscal years. Under this provision, repetition of the disclosure is not required when a company uses classes of similar products or services as its basis for determining lines of business.

In September 1969, the Commission issued a proposal for comment, based on a recommendation of the Disclosure Study, which would amend the annual reporting form under the Securities Exchange Act to require disclosure of comparable data.

Organized Crime Program

The Commission has always given priority to the investigation of cases where there is an indication that organized crime may be involved. The Commission maintains a close liaison with the Organized Crime and Racketeering Section of the Department of Justice and submits quarterly reports relating to organized crime investigations. At the request of the Attorney General, the Commission requested that its appropriation for fiscal year 1970 include funds which would enable it to mount an increased drive against organized crime within the Commission's over-all enforcement program. During the 1969 fiscal year, the Commission placed four enforcement staff members on the Department of Justice's New York Strike Force against organized crime, and designated enforcement staff members in its headquarters office to investigate certain organized crime cases. It is anticipated that additional enforcement personnel will be assigned to Department of Justice Strike Forces in other major cities, and that a "back-up" unit will be created in the Commission's headquarters office to assist in establishing an effective program to keep organized crime out of the securities markets.

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, generally speaking, 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 the registration of securities listed on a national securities exchange as well as of over-the-counter securities in which there is a substantial public interest. It also requires the issuers of such securities 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 in connection with the solicitation of proxies for the election of directors or the approval of corporate action at a stockholders' meeting, 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 early in the 1969 fiscal year by the "take-over-bid" amendments to the Securities Exchange Act, which, as implemented by Commission rules, afford 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.

The program for revision of the Commission's disclosure requirements recommended by the Disclosure Study Report, which was submitted to the Commission in March 1969, and the steps which have been taken to implement the recommendations, are discussed in Part I of this report.

A. DISCLOSURE IN CONNECTION WITH PUBLIC OFFERINGS

In order to provide disclosure 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, the Securities Act requires that (1) a registration statement containing certain required financial and other information be filed with the Commission, and (2) 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.

Prior Delivery of Preliminary Prospectus

The Act provides that a registration statement shall become effective on the 20th day after filing, or the 20th day after the last amendment is filed. The Commission can, however, set an earlier effective date ("accelerate" the effective date), taking into account among other things the adequacy of the information theretofore publicly available.

During the fiscal year, the Commission announced a new acceleration policy, relating to the distribution of prospectuses to prospective investors. In doing so, it called attention to the continued high volume of filings and the fact that well over half of the filings were being made by companies filing for the first time, and it emphasized that the investing public should be aware that many such offerings of securities are of a highly speculative character and that the prospectus should be carefully examined before an investment decision is reached.

The Commission had previously declared its policy in Rule 460 that it will not accelerate the effective date of a registration statement unless the preliminary prospectus contained in the registration statement is distributed to underwriters and dealers who it is reasonably anticipated will be invited to participate in the distribution of the security to be offered or sold. The purpose of this requirement is to afford all persons effecting the distribution a means of being informed with respect to the offering so that they can advise their customers of the investment merits of the security.

The Commission announced that it would henceforth consider whether persons making an offering of securities of an issuer which is not subject to the reporting requirements of the Securities Exchange Act of 1934 had taken reasonable steps to furnish preliminary prospectuses to those persons who may reasonably be expected to be purchasers of the securities. The Commission will ordinarily be satisfied by a written statement from the managing underwriter to the effect that it has been informed by participating underwriters and dealers that copies of the preliminary prospectus have been or are being distributed to all persons to whom it is then expected to mail confirmations of sale, not less than 48 hours prior to the time it is expected to mail such confirmations.

Proposed Summary Sheet For Registration Statements

During the fiscal year, the Commission invited public comments on proposed amendments to its forms and rules under the Securities Act to require companies filing registration statements to file a summary sheet as an exhibit to each statement or amendment. The sheets would summarize essential information relating to the registrant and the registration statement and are designed to facilitate the automated processing of data through the use of the Commission's computer; the Commission's recordkeeping, including its internal workload control; and the dissemination of information to the Commission's regional offices for public information purposes. The information in the summary sheets would be confined substantially to information which is presently required by the registration forms.

Some copies of each summary sheet would be kept in the Commission's principal office for the use of the staff and for public inspection while other copies would be placed in the regional offices of the Commission so that the information would be more readily available to interested persons.

Guides for Preparation and Filing of Registration Statements

During the fiscal year the Commission published certain guides for the preparation and filing of registration statements under the Securities Act. These guides represented a revision and expansion of guides previously published.

The guides are subject to review and modification from time to time as circumstances may require and interested persons are invited to submit, at any time, suggestions for such modifications or for the publication of guides covering additional matters. They are not rules of the Commission nor are they published as bearing the Commission's official approval. The guides represent policies and practices followed by the Commission's Division of Corporation Finance in the administration of the registration requirements of the Act, but they do not purport to furnish complete criteria for the preparation of registration statements.

In April 1969, a proposed guide of the Division, relating to the misleading character of certain registrants' names, was published. It stated that the Division had observed that an increasing number of registrants proposed to adopt names which could create a misleading impression as to the nature of their business. For examples, registrants proposed to use words such as "nuclear," "missile," "space," "nucleonics" or "electronics" in their names where they were not engaged, or engaged only to a very limited extent, in activity normally associated with those words.

The release further stated that the Division also may deem a registrant's name to be misleading if it is so similar to the name of another company, particularly a well-known and established company, that it is likely to be confused with the name of that company.

Following the close of the fiscal year, the proposed guide was adopted.

Amendment of Rule 429

Rule 429 under the Securities Act previously provided that where two or more registration statements were effective for different blocks of securities of the same class, a combined prospectus could be used in connection with the offering and sale of the securities covered by such registration statements provided the prospectus contained the information with respect to the underwriting and distribution of the securities and the use of the proceeds therefrom which would be required in each prospectus if separate prospectuses were used.

During the fiscal year the rule was amended to provide that such a combined prospectus may be used even though the securities covered by the several registration statements are not all of the same class. Use of the combined prospectus is not permitted, however, where the latest registration statement is filed on Form S-14. The reason for this is that a prospectus for securities registered on Form S-14 consists of a proxy statement supplemented by certain additional information. Such a prospectus is not deemed suitable for securities other than those for which that form may be used.

Spin offs of Securities and Trading in the Securities of Inactive or Shell Corporations

Shortly after the end of the fiscal year, the Commission issued a release expressing its concern with the methods being employed by a growing number of companies and persons to effect distributions to the public of unregistered securities in possible violation of the registration requirements of the Securities Act and the anti-fraud and anti-manipulative provisions of that Act and the Securities Exchange Act.

The Commission pointed out that the methods employed can take and in fact have taken a variety of patterns. Frequently, the pattern involves the issuance of its shares by a company with little, if any, business activity to a publicly-owned company in exchange for what may or may not be nominal consideration. The publicly-owned company subsequently "spins off" the shares to its shareholders and active trading in the shares begins although no information on the issuer is available to the investing public. The potential for fraud and deceit in these situations is manifest. The Commission stated that it takes the position that the shares distributed in certain spin offs are subject to the registration requirements of the Securities Act and subsequent transactions in the shares by dealers, unless otherwise exempt, are subject to the provisions of the Act requiring the delivery of a prospectus.

The Commission pointed out that it was not, in this release, addressing itself to problems attributable to more conventional spin offs, which do not involve a process of purchase of securities by a publicly-owned company followed by their spin off and redistribution in the trading markets.

Another pattern discussed in the release involves the acquisition by certain promoters of corporations which have ceased active operations, or which have little or no assets ("shell corporations"), and which have a substantial number of shares outstanding, generally in the hands of the public. Following such acquisition, the promoters have engaged in activities designed to increase quickly the market value of their shareholdings. For example, in some cases promoters have initiated a program of acquisitions, transferring assets of dubious value to the "shell corporations" in exchange for substantial amounts of newly issued shares. This activity is frequently accompanied by publicity containing exaggerated or misleading statements and designed to stimulate interest of public investors in the company's shares in violation of the anti-fraud provisions of the Securities Exchange Act. Thereafter the market prices of these securities have risen sharply under circumstances which bear no relationship to the underlying financial condition and business activities of the company.

In some of these cases the promoters or other corporate insiders, taking advantage of the market activity and the price rise which they have generated, have sold their shares at the inflated prices to the public in violation of the registration and anti-fraud provisions of the Federal securities laws.

The Commission stressed that activity of the type described in the release generally can be accomplished successfully only through the efforts of brokers and dealers, and it cautioned brokers and dealers to be mindful of their obligations under the securities laws In effecting transactions in securities of little-known, inactive issuers, or issuers as to which there is no reliable current information available.

Staff Examination of Registration Statements

Registration statements filed with the Commission are examined by its staff for compliance with the standards of adequate and accurate disclosure. This examination is primarily the responsibility of the Division of Corporation Finance. [Footnote: Statements filed by investment companies registered under the Investment Company Act of 1940 are examined by the Division of Corporate Regulation. See Part V for further discussion of the processing of investment company registration statements.] Expedited review procedures adopted in November 1968 to cope with the tremendous volume of registration statements filed were described on pages 11-12 of the 34th Annual Report. Generally speaking, if it appears that a statement fails to conform, in material respects, with the applicable requirements, the issuing company is 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 1969 is discussed on page 36.

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, among other things, the adequacy of the information respecting the issuer theretofore available to the public and the facility with which the facts about the offering can be understood. 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.

During the fiscal year, a record number of 3,316 registration statements became effective. As a result of the enormous number of filings 13 and the resulting backlog, the median time from the date of original filing to effective date rose to 65 calendar days. This compares with 44 days for 2,131 registration statements in fiscal year 1968 and 36 days for 1,460 registration statements in fiscal year 1967.

The following table shows by months during the 1969 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 the 1969 fiscal year, 4,706 registration statements were filed for offerings of securities aggregating $86.9 billion. These record figures compare with 2,906 registration statements filed during the 1968 fiscal year for offerings amounting to $54.0 billion and represent an increase of 61.9 percent in the number of statements filed and 60.9 percent in the dollar amount involved.

Of the 4,706 registration statements filed in the 1969 fiscal year, 2,350, or 49.9 percent, were filed by companies that had not previously filed registration statements under the Securities Act of 1933. Comparable figures for the 1968 and 1967 fiscal years were 893, or 30.7 percent, and 440, or 24 percent, respectively.

From the effective date of the Securities Act to June 30, 1969, a total of 36,567 registration statements, covering proposed offerings of securities aggregating over $485.9 billion, was filed by 15,748 different issuers. The following table contains further particulars concerning these statements:

[table omitted]

As the above table shows, 202 registration statements were withdrawn during the 1969 fiscal year. The reasons given by registrants for requesting withdrawal were as follows:

[table omitted]

Statistics Regarding Securities Registered

During the fiscal year 1969 a record 3,645 registrations of securities in the amount of $86.8 billion became effective under the Securities Act. Both the number of statements and the dollar amount of registrations were the largest on record. The chart on page 201 shows the number and dollar amounts of registrations for the past 35 years.

The figures for 1969 include all registrations which became effective including secondary distributions, i.e., distributions of already outstanding securities, 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 1969, 60 percent was for the account of the issuer for cash sale, 34 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]

As the above table shows, the amount of securities offered for cash sale for the account of the issuer approximated $52 billion, an increase of $15 billion over the previous year. Registration of securities for the account of the issuer for other than cash sale totaled $29.6 billion, more than double the amount during the preceding fiscal year. These securities included $17.8 billion of securities registered for exchange transactions and $11 billion of securities reserved for conversion. Registrations of secondary offerings totaled $4.8 billion, $1.7 billion more than in the preceding fiscal year. Appendix Table 1 shows the number of statements which became effective and total amounts registered for each of the fiscal years 1935 through 1969, and contains a classification by type of security of issues to be offered for cash sale on behalf of the issuer during those years. More detailed information for 1969 is given in Appendix Table 2.

Corporate issues intended for immediate cash sale totaled $17.3 billion, an increase of $900 million over the preceding year. Common stock totaled $5.9 billion, or 34 percent of the total, as compared to $2.9 billion, or 17 percent, in the preceding fiscal year. Preferred stock totaled $500 million, 3 percent of the total, while bonds, notes and debentures aggregated $10.8 billion, or three-fifths of the total. A breakdown of registered corporate issues for cash sale by industry of issuer and data on the intended use of proceeds will not be available until programs to adapt these statistics to the Commission's computer are completed.

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

[table omitted]

Registration of issues to be offered over an extended period amounted to $34 billion, an increase of over $14 billion as compared to 1968 and the largest amount on record. These issues are classified below:

[table omitted]

Stop Order Proceedings

Section 8 (d) of the Securities Act 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, one stop order proceeding was pending. During the year five additional proceedings were instituted and three were terminated through the issuance of stop orders.

Examinations and Investigations

The Commission is authorized by Section 8 (e) of the Securities 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 conduct 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 (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 1969 fiscal year, 1,043 notifications were filed under Regulation A, covering proposed offerings of $267,074,784, compared with 515 notifications covering proposed offerings of $112,318,744 in the 1968 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 1969,1,897 reports of sales were filed reporting aggregate sales of $157,903,374.

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 1969 fiscal year, temporary suspension orders were issued in 15 cases, which, added to the 2 cases pending at the beginning of the fiscal year, resulted in a total of 17 cases for disposition. Of these, the temporary suspension order was vacated in one case and became permanent in eight cases: in two by lapse of time, in four by withdrawal of the request for hearing, and in two by acceptance of an offer of settlement. Eight cases were pending at the end of the fiscal year.

Exempt Offerings Under Regulation B

During the fiscal year ended June 30, 1969, 613 offering sheets and 447 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 1968 and 1967 fiscal years, 453 and 353 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 1967-69. 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 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 similar in many respects 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.

Regulation E also authorizes the Commission to suspend an exemption, substantially on the same grounds as those specified in Regulation A.

One notification was filed under Regulation E during 1969 fiscal year for an offering totalling $160,000.

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 1969 fiscal year, 18 notifications were filed under Regulation F, covering assessments of $492,076, compared with 20 notifications covering assessments of $835,274 in the 1968 fiscal year. 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. One Regulation F exemption was suspended during the fiscal year.

B. CONTINUING DISCLOSURE REQUIREMENTS

The Securities Exchange Act of 1934, as amended, contains a number of significant disclosure provisions with respect to securities traded in the securities markets. These provisions, applicable in general to issuers of securities listed on exchanges and issuers of securities traded over-the-counter which meet minimum asset and number of stockholder tests, include requirements for the registration of securities with the Commission and for periodic reports, as well as for appropriate disclosure in connection with the exercise of stockholders' voting rights, takeover bids and insiders' securities transactions.

Registration of Securities on Exchanges

Unless a security is registered on a national securities exchange under Section 12 (b) of the Exchange Act 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 $1 million and a class of equity securities held of record by 500 or more persons to register those securities with the Commission, unless one of the exemptions set forth in that section is available, or the Commission issues an exemptive order under Section 12 (h).

During the fiscal year, 651 registration statements were filed under Section 12 (g). This makes a total, from the enactment of Section 12 (g) in 1964, through June 30, 1969, of 3,819 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.

Of the 651 registration statements filed under Section 12 (g) in fiscal year 1969, 353 were filed by issuers already subject to the reporting requirements of Section 13 or 15 (d) of the Act. The latter figure includes 22 registration statements filed by issuers with another security registered on a national securities exchange, and 331 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 other disclosure and insider trading provisions of Sections 14 and 16 of the Exchange Act. The remaining 298 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.

Adoption of Rule 12g-2, During the fiscal year the Commission adopted a rule relating to the registration of securities under Section 12 (g) of the Exchange Act. That section exempts from registration securities listed and registered on a national securities exchange and securities issued by an investment company registered under the Investment Company Act of 1940. The new rule provides that where a class of securities would have been required to be registered except for the fact that it was so exempt, when the exemption terminates such class shall be deemed to be registered under Section 12 (g) if at that time securities of the class are held of record by 300 or more persons. Thus, the rule accomplishes the transition from registration under Section 12 (b) or under the Investment Company Act to registration under Section 12 (g) without the necessity of filing an additional registration statement.

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.

At the beginning of the fiscal year 17 applications were pending and 10 were filed during the year. Of these 27 applications, 6 were withdrawn, 12 were granted and-1 was denied. The remaining 8 applications were pending at the end of the fiscal year.

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. Certain real estate companies are required to file quarterly reports on Form 7-K. 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, 1969, there were 2,764 issuers having securities listed on a national securities exchange and registered under Section 12 (b) of the Act, 3,331 issuers having securities registered under Section 12 (g), and 2,359 additional issuers which were subject to the reporting requirements of Section 15 (d) of the Act.

[table omitted]

Administrative Proceedings to Obtain Compliance with Exchange Act Registration or Reporting Requirements

Section 15 (c) (4) of the Exchange 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 in any material respect to comply with any of those provisions. This establishes an administrative procedure, similar to that provided in proceedings to delist securities under Section 19 (a) (2) of the Exchange Act, for apprising investors of materially misleading filings and for the resolution of accounting and other complex and technical questions involving the disclosure provisions of the Act. Under Section 15 (c) (4) the Commission can publish its findings and issue an order requiring compliance and, when the circumstances of a particular case so warrant, apply to a U.S. district court for enforcement of its order.

Two proceedings under Section 15 (c) (4) were pending as of the end of the fiscal year, in one of which 18 it is alleged that a schedule filed in connection with a tender offer was misleading. This is the first administrative proceeding arising out of the "Takeover Bid Bill" enacted in July 1968.

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. 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 security holders are asked to vote, and they must be afforded an opportunity to vote "yes" or "no" on each matter other than elections. 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."

Amendment of Item 7 (f) of the Proxy Rules. -- During the fiscal year, the Commission adopted a clarifying amendment to its proxy rules to codify a long-standing interpretation of Item T (f) of Schedule 14A, which specifies the information to be included in proxy statements. Item 7 (f) calls for information with respect to the interests of insiders in transactions to which the issuer or any of its subsidiaries was or is to be a party. Instruction 3 to that item permitted the omission of information as to certain indirect interests, including those which arise from the ownership of a limited equity interest in another party to the transaction. The amendment makes it clear that a general partnership interest is regarded as being more than an "equity interest"; it is regarded as the equivalent of the interest of a corporate officer who has an equity interest in the corporation.

Amendment of Rule 14c-2. -- During the fiscal year the Commission amended Rule 14c-2 of Regulation 14C. That rule previously required the transmission of an information statement only where action was to be taken at an annual or other meeting of the holders of a class of registered securities. The rule was amended so that it would apply, not only where action is to be taken at a meeting of security holders, but also where corporate action is to be taken with the written authorization or consent of the holders of a class of registered securities.

Recent changes in the corporate codes of certain states (notably Delaware and Pennsylvania) permit the taking of certain corporate action, which would normally be voted upon at a meeting of security holders, by securing the written authorization or consent of the requisite percentage of the holders of securities of the class entitled to vote. Thus, the rule amendment was necessary to prevent important corporate action being taken under the above-mentioned statutory provisions by a relatively few large stockholders without the prior knowledge or consent of the other stockholders.

Statistics Relating to Proxy and Information Statements. -- During the 1969 fiscal year, 5,316 proxy statements in definitive form were filed, 5,284 by management and 32 by nonmanagement groups or individual stockholders. In addition, 115 information statements were filed. The proxy and information statements related to 4,940 companies, some 491 of which had a second solicitation during the year, generally for a special meeting not involving the election of directors.

There were 4,548 solicitations of proxies for the election of directors, 742 for special meetings not involving the election of directors, and 26 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 1969 fiscal year, 173 proposals submitted by 27 stockholders were included in the proxy statements of 118 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 48 additional proposals submitted by 21 stockholders was omitted from the proxy statements of 19 companies in accordance with Rule 14a-8. The principal reasons for such omissions and the number of times each such reason was involved (counting only one reason for omission for each proposal even though it may have been omitted under more than one provision of Rule 14a-8) were as follows:

[table omitted]

Ratio of Soliciting to Nonsoliciting Companies. -- Of the 2,764 issuers that had securities listed and registered on national securities exchanges as of June 30, 1969, 2,538 had voting securities so listed and registered. Of these 2,538 issuers, 2,354, or 90.6 percent, solicited proxies under the Commission's proxy rules during the 1969 fiscal year for the election of directors.

Proxy Contests. -- During the 1969 fiscal year, 25 companies were involved in proxy contests for the election of directors. A total of 549 persons, both management and nonmanagement, filed detailed statements as participants under the requirements of Rule 14a-11. Proxy statements in 20 cases involved contests for control of the board of directors and those in 5 cases involved contests for representation on the board.

Management retained control in 8 of the 20 contests for control of the board of directors, 2 were settled by negotiation, nonmanagement persons won 3, 1 resulted in a tie and 6 were pending as of June 30, 1969. Of the five cases where representation on the board of directors was involved, management retained all places on the board in three contests, opposition won places on the board in one case and one was settled by negotiation.

Disclosure in Connection with Takeover Bids and Oilier Large Acquisitions

Amendments to Sections 13 and 14 of the Exchange Act relating to full disclosure in connection with cash tender offers and other stock acquisitions which may cause a shift in control became effective on July 29, 1968.23 This legislation, which is more fully described in the previous annual report, was designed to close gaps in the full disclosure provisions of the securities laws and to put cash tender offers and other block acquisitions on the same footing as proxy contests for control.

During the fiscal year, the Commission adopted temporary rules and regulations to make the provisions of the legislation operative.

Rule 13d-1 under the Act among other things requires the filing with the Commission of a Schedule 13D report by a person or group which acquires any of a class of equity securities registered pursuant to Section 12 of the Act or issued by a closed-end investment company registered under the Investment Company Act, if such acquisition results in the ownership by such person or group of more than 10 percent of such class of securities. During the 1969 fiscal year 251 Schedule 13D acquisition reports were filed. Rule 14d-4 requires the filing of a Schedule 13D report by a person or group making a tender offer (other than an exchange offer by means of a registration statement under the Securities Act of 1933) which, if successful, would result in such person or group owning more than 10 percent of any class of equity securities of the type described above. Seventy Schedule 13D tender offer reports were filed during the fiscal year.

In addition, 56 Schedule 14D reports were filed pursuant to Rule 14d-4 which relates to solicitations or recommendations in connection with a tender offer by one other than the maker of the offer, and 12 statements were filed pursuant to Rule 14f-1 relating to the replacement of a majority of the board of directors otherwise than by stockholder vote pursuant to an arrangement or understanding with the person or persons acquiring securities in a transaction subject to Sections 13 (d) or 14 (d) of the Act. No statements were filed pursuant to Rule 13e-1 relating to the reacquisition of its securities by an issuer while it is the target of a cash tender offer.

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, 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, 93,708 ownership reports (16,036 initial statements of ownership on Form-3 and 77,672 statements of changes in ownership on. Form 4) were filed with the Commission. By comparison, during fiscal year 1968, 93,823 such reports were filed (14,893 initial statements and 78,930 statements of changes).

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.

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 time 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.

Proposed Amendment of Rule 16a-1. -- During the fiscal year the Commission invited public comments on certain proposed amendments to Rule 16a-1 which relates to the filing of statements of beneficial ownership of equity securities, and changes in such ownership, pursuant to Section 16 (a) of the Act, and, after the close of the fiscal year, it adopted the amendments in modified form.

One of the amendments requires a person who has become a director or officer of a company whose equity securities are registered pursuant to Section 12 of the Act, or who is a director or officer of a company whose securities have become so registered, to furnish with any statement regarding changes in his beneficial ownership of equity securities occurring within 6 months after he became subject to Section 16 (a) information as to any changes in such beneficial ownership which occurred during the preceding 6 months. The other amendment requires any person who has ceased to be a director or officer of such a company, or who was a director or officer at the time the company ceased to have any equity securities registered pursuant to Section 12, to file a report with respect to any change in beneficial ownership which occurs within 6 months after any change in beneficial ownership prior to such cessation.

The purpose of the amendments is to provide disclosure under Section 16 (a) of the Act with respect to all transactions which may be subject to Section 16 (b) of the Act. The courts have held that for the purpose of Section 16 (b) a purchase of an equity security made before a person becomes a director or officer of a company having such securities registered pursuant to Section 12 of the Act may be matched with a sale within 6 months thereafter at a time when such person has become a director or officer of the company. Similarly, it has been held that for the purpose of Section 16 (b), a purchase of an equity security of such a company by another company having a representative on the first company's board of directors may be matched with a sale of such security, within 6 months, after the representative ceased to be a director of the company. The same principles would seem to apply where equity securities become registered, or cease to be registered, between the dates of purchases and sales, or sales and purchases, made within a period of 6 months.

Changes in Rule 16b-3. -- 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-3 exempts from Section 16 (b) of the Act the acquisition of certain securities pursuant to stock bonus, profit sharing, retirement and similar plans which meet certain specified conditions. The rule exempts the acquisition of shares of stock other than stock acquired upon the exercise of options, warrants or rights and also exempts the acquisition of restricted, qualified and employee stock purchase plan stock options, but not the acquisition of stock upon the exercise of such options.

Paragraph (d) (3) of Rule 16b-3 previously provided that the term "exercise of an option, warrant or right," as used in the rule, did not include the making of an election to receive under any plan an award of compensation in the form of stock or credits therefor, provided the election is made prior to the award and subject to certain other conditions. However, in some instances the election to receive stock under a plan is made annually with respect to the portion of the award relating to the particular year. For this reason paragraph (d) (3) of the rule was amended during the fiscal year to provide that an election made on an annual basis is not deemed to be the "exercise of an option, warrant or right," within the meaning of the rule, provided it is made either prior to the award or prior to the fulfillment of all conditions to the receipt of the compensation.

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]

Section 19 (a) (4) of the Exchange Act authorizes the Commission summarily to suspend exchange trading in a security listed on a national securities exchange for up to 10 days if in its opinion the public interest so requires. Under Section 15 (c) (5) of that Act the Commission may summarily suspend over-the-counter trading in any non-exempt 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 1969 fiscal year, the Commission temporarily suspended trading in 33 securities, compared to 39 in fiscal 1968 and 22 in fiscal 1967. In seven 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 halted trading.

The principal grounds on which the Commission ordered suspension of trading were that adequate or accurate information concerning the issuer was not available; it appeared that misleading information was being circulated; there was a need for clarification of information published about the company; 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 company or the purchase or sale of its securities. For example, suspensions were ordered pending clarification and/or adequate public dissemination of information concerning: the market activity in a company's shares despite a corporate by-law restricting their transferability; the company's principal product and its future prospects; the apparent absence of any known properties or operations; the extent of losses discovered by the company; financial statements of the company and of companies acquired; the existence of a genuine market for the company's stock at the prices at which it had recently been quoted; circumstances surrounding a change of control, the company's acquisition program, accuracy and completeness of filings made with the Commission by the company and certain transactions in the company's securities by insiders and others; and the offer and sale of stock allegedly sold as "lettered stock" (i.e., stock purportedly issued pursuant to an exemption from registration).

In 13 cases, the Commission instituted enforcement action subsequent to or concurrently with the trading suspension where violations of law were indicated. For example, the Commission had suspended over-the-counter trading in the common stock of Omega Equities, Corporation following a spectacular increase in the market price of such stock within a few months. The Commission noted that it had received information indicating that the securities of Omega, a so-called "emerging conglomerate," were being sold on the basis of incomplete and inaccurate information relating to the company's financial condition, product lines and acquisition program. It also noted that serious questions had been raised as to whether so-called "lettered stock" reportedly issued at prices substantially below the prices then being publicly quoted was being issued without compliance with the registration and anti-fraud provisions of the Federal securities laws. Thereafter, the Commission filed a complaint in the U.S. District Court for the Central District of California, alleging, among other things, that Omega, its officers and directors, and others had violated those provisions in the course of a program which involved reconstituting Omega (which had an operating deficit of over $14 million) as a conglomerate through the acquisition of a number of businesses and obtaining the necessary cash through the sale of unregistered "letter" securities at prices far below current market prices. Omega and nine other defendants, while denying the allegations, consented to a final decree permanently enjoining them from engaging in conduct in violation of the Federal securities laws, as alleged in the complaint. The suspension of trading was then terminated by the Commission.

In another case, involving United Australian Oil, Inc., the Commission suspended trading in the company's stock on the basis of information that the price had risen sharply and the fact that there appeared to be no financial information currently available about the company and information currently being circulated about the company's assets and operations appeared to be inaccurate and incomplete. The company and its president had previously been enjoined from further violations of the registration provisions of the Securities Act. Company representatives had refused to provide pertinent information and documents and the Commission had obtained an order directing the president to comply with a subpoena requiring the production of corporate records. Upon his failure to comply with that order, the president was found guilty of civil contempt and was sentenced to 6 months in jail or until he purged himself by producing the records or giving a satisfactory explanation of his failure to do so. United previously had pled guilty and its president nolo contendere to a charge of criminal contempt of the injunctive order. The Commission terminated the trading suspension in August 1969. In its release announcing such action, the Commission pointed out, among other things, that the company was apparently insolvent and had no current operations, and it cautioned investors to consider this and other adverse information recited in the release, including the matters referred to above.

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.

The rules and regulations thus established, except for the uniform systems of accounts which are regulatory reports, prescribe accounting principles to be followed only in certain limited areas. In the large area of financial reporting not covered by 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 professional person not connected with the management.

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

Relations with the Accounting Profession and the Public

In order to keep abreast of such changes and new developments 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, the National Association of Accountants, and the National Association of Railroad and Utilities Commissioners. Since the American Institute of Certified Public Accountants is the principal organization involved in the development and improvement of accounting and auditing standards and practices in the profession, regular liaison is maintained with it through its Committee on Relations with Securities and Exchange Commission and Stock Exchanges. Conferences are held from time to time at which the staff is briefed on the work being done by the Institute, including its Committees on Ethics and Auditing Procedures and the Accounting Principle Board, and problems of mutual interest are discussed. A similar program of meetings is being instituted with the Committee on Corporate Reporting of the Financial Executives Institute.

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, both the Chairman and the Chief Accountant have urged the profession to restudy the accounting principles applicable to business acquisitions or combinations in order to develop criteria which will 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 Chairman included a statement expressing his concern on this matter in testimony before the Subcommittee on Commerce and Finance of the House Committee on Interstate and Foreign Commerce in February 1969. 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 foreign accounting conferences or writes for foreign professional journals. During the fiscal year, he presented a paper at the Annual Conference of the Institute of Chartered Accountants of Ontario at Ottawa, Canada, and contributed an article for publication in The Accountants Magazine, the journal of the Institute of Chartered Accountants of Scotland.

The Work of the Accounting Principles Board

The Accounting Principles Board sponsors research studies of problem areas in accounting and formulates formal opinions and advisory statements for the improvement of accounting standards and practices. The advisory statements contain recommendations of the Board which companies may adopt voluntarily. In furtherance of the policy of cooperation between professional organizations and the Commission, the Board submits drafts of these studies, opinions and statements to the Chief Accountant for review and comment prior to publication, and representatives of the Board confer with him on projects in progress or under consideration.

During the fiscal year the Board issued three opinions, one of which, entitled "Earnings per Share," was an extensive revision and clarification of a prior opinion which became necessary because of the proliferation of increasingly complex securities. Another opinion presented the results of a restudy of the accounting for convertible debt and debt issued with stock purchase warrants. The third opinion removed an exemption, which had applied to the financial statements of commercial banks, from the requirements of an opinion that specified the format of the income statement in regard to the determination of net income. In July 1969, representatives of the banks, the Federal regulatory agencies and the American Institute of Certified Public Accountants agreed upon specific standards to be followed by the banks in previously unsettled areas which are to be incorporated into the uniform reporting requirements of the three bank regulatory agencies and the AICPA guide "Audits of Banks." Also in July the Board issued a statement, "Financial Statements Restated for General Price-Level Changes," in which the benefits of such statements when presented on a supplemental basis are discussed, but which recommends against their substitution for the basic historical-dollar financial statements. This statement deals with a long-standing problem.

The Board has indicated that it has given top priority to a reexamination of the problems of accounting for business combinations and it expects to issue an opinion on this subject by June 1970. Also scheduled for issuance in the early part of 1970 are opinions on the equity method of accounting for intercorporate investments, and on the effects of changes in accounting methods, and a statement urging that companies include a statement of their accounting principles in their annual reports. Other topics on which the Board or its subcommittees are working with a view to issuing opinions are: segmented data in the financial statements of diversified companies (for the Commission's recently adopted rules in this area, see pages 22-24, supra.), capitalization of leases, preparation of interim financial statements, valuation of marketable securities, and components of a business enterprise. A subcommittee is also developing a document pertaining to basic concepts and accounting principles underlying financial statements of business enterprises.

Research studies are being conducted on the subjects of extractive industries (completed in December 1969), materiality, research and development, foreign operations, stockholder equities, and asset and liability valuation in income determination. Two other research projects are being prepared on inventory pricing and depreciation methods.

In connection with the development of opinions in four problem areas, earnings per share, business combinations, the equity method of accounting and the valuation of marketable securities, the Board sponsored symposiums attended by representatives of all professional groups concerned with the particular accounting problems, including the Commission, in order to foster a better understanding of the problems and agreement on the proposed solutions.

Other Current Developments

The Chief Accountant's Office is continuing its work on the project of 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. A committee of the AICPA has submitted many helpful suggestions for revisions. More recently recommendations for revisions, particularly with respect to the schedules specified in Regulation S-X, were made by the Commission's Disclosure Study Group. The Commission issued a proposal in September 1969, to include in Regulation S-X a section which would specify the content of a statement of source and application of funds. This proposal reflected recommendations by the Study Group, as well as by the AICPA and other professional groups, that such statements be required in certain filings made by registrants. At that time the Commission also issued proposals to require such statements in registration statements and annual reports filed under the Exchange Act.

During the fiscal year a compilation of all the Accounting Series Releases was completed for printing in one volume. In this compilation each release number is retained together with a brief statement of circumstances or problems which made the release necessary at the time it was issued, but only those releases which appear to be of value currently were included in their entirety.

During the prior fiscal year the Chief Accountant's Office studied questions relating to the independence of accountants who examine a nonmaterial foreign segment of an international business, in lieu of the independent accountants of the parent company in the United States. In August 1968, the Commission issued an interpretative release which stated that, insofar as ownership of securities by partners is concerned, the accounting firm performing the audit of the division or 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.

D. CIVIL LITIGATION INVOLVING DISCLOSURE MATTERS

As more fully discussed below, the Commission in its enforcement program frequently institutes injunctive actions in the Federal district courts in order to halt or prevent violations of the statutes administered by it and of its rules adopted thereunder. Many of these actions relate in whole or in part to noncompliance with the various disclosure requirements. In many other cases the Commission participates as amicus curiae in litigation between private parties where it is requested to do so by the court or where it deems it important to furnish to the court its views regarding the interpretation of statutory provisions or of its rules. Two such cases relating to disclosure matters are discussed below. Civil litigation relating to other phases of the Commission's work is discussed in Parts IV-VII of this report.

The Commission sought the aid of the courts on several occasions during the fiscal year in order to insure compliance with the reporting requirements of the Exchange Act. Thus, for example, in S.E.C. v. Golconda Mining Co., summary judgment was entered in the Commission's favor on its allegation that, in violation of Section 16 (a) of that Act, Harry F. Magnuson, a director of Hecla Mining Company, had failed to file timely ownership reports and had filed false reports regarding numerous transactions in that company's stock. The court found that a similar pattern obtained as to the stock of seven other corporations of which Magnuson was also a director, and it therefore enjoined Magnuson from future violations of Section 16 (a) with respect to any securities registered on a national securities exchange. In Gerstle v. Gamble-Skogmo, Inc., an action in which shareholders of a company merged into Gamble alleged that a proxy statement for the merger was materially misleading, the District Court for the Eastern District of New York made several significant rulings relating to disclosure of the value of assets in such a proxy statement. The court adopted the views expressed by the Commission, amicus curiae, that

(1) good faith offers from third parties to buy corporate assets for more than their book value must be disclosed in the proxy statement if their omission would render the statement materially misleading, but the corporation's own asking price for the properties may not be disclosed;

(2) except when expressly authorized by statute or Commission rule, assets may not ordinarily be written up above cost in either the body or the footnotes of financial statements filed with the Commission; and

(3) existing asset appraisals of current liquidating value made by qualified experts and having a sufficient basis in fact must be disclosed in the text or narrative portion of a proxy statement for a merger or sale of assets, along with a summary statement of (a) the factual basis for the appraisal, (b) the relationship-if any-between the appraiser and interested persons and (c) the terms of the appraiser's engagement, including the instruction given to the appraiser as to the purpose and method of appraisal, if the failure to disclose such appraisals would render the proxy statement materially misleading.

The court also held that in an action brought under the proxy provisions of the Exchange Act proof of an intent to deceive is not required, stating that "[n]egligence alone either in making a misrepresentation or in failing to disclose a material fact in connection with proxy solicitation is sufficient to warrant recovery." It further held that in actions under the proxy provisions, the plaintiffs are not required to establish "causation" by direct proof that with proper disclosure enough shareholders would have voted against the merger to defeat it, but that causation would be inferred if the " 'reasonable man' test" 51 had been satisfied.

In Chapman v. Dunn, an action for rescission by purchasers of unregistered fractional interests in oil and gas leases, the Commission filed a brief, amicus curiae, in which it argued that the intrastate exemption from the registration provisions of the Securities Act provided by Section 3 (a) (11) was not available for the sale of such interests to residents of the same State of which the individual issuer was a resident and in which he maintained his office, where the land covered by the leases was located in another State. The Commission urged that in such cases Federal regulation is necessary because State securities commissions cannot investigate the out-of-State activities in order to determine whether the issuers' public disclosures of their financial affairs are fair and adequate for the protection of investors. The court adopted the Commission's reasoning that the issuer was not "doing business" in his home State, as required by Section

E. CRIMINAL PROSECUTIONS INVOLVING DISCLOSURE VIOLATIONS

During the fiscal year a significant appellate decision was handed down in a case involving noncompliance with the Securities Act registration provisions, which had been referred by the Commission to the Department of Justice for criminal prosecution.

In United States v. Wolfson, the court of appeals for the second circuit affirmed the convictions of Louis Wolfson and Elkin Gerbert for violating Section 5 of the Securities Act in selling unregistered "control" stock of Continental Enterprises, Inc. The court held among other things that : (1) neither Section 4 nor Section 5 of the Securities Act, nor the concept of "control" stock, are unconstitutionally vague or indefinite; (2) a person need not be an officer or director of an issuer to be deemed a "control" person for the purposes of Section 5; (3) the exemption from the registration provisions of Section 5 provided by Section 4 (1) for "transactions by any person other than an issuer, underwriter or dealer" is not available for the sale of stock of a "control" person since a person taking the stock from a "control" person becomes a statutory "underwriter"; and (4) a "control" person cannot claim the exemption under Section 4 (4) for unsolicited brokers' transactions, even though a broker selling stock for him may be entitled to that exemption where the broker is not aware of circumstances indicating that the "control" person is engaged in a distribution.

Also during the fiscal year, the former treasurer and a director of General Development Corporation was convicted of wilfully violating Section 16 (a) of the Exchange Act by failing to file with the Commission and the American Stock Exchange a Form 4 Statement reflecting "insider" sales of securities of General Development on his behalf.

Additional information regarding the Commission's criminal reference activities and summaries of other significant cases, some of which also involved violations of the registration provisions together with other violations, may be found in Part IV of this report.

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.

Gross income of the Bank for the fiscal year ended June 30, 1969, was $410 million, compared with $356 million in 1968. Expenses, which included $197 million for interest on Bank borrowing, bond issuance and other financial expenses, totaled $239 million, compared with $187 million last year. Net income in 1969 amounted to $171.4 million compared with net earnings of $169.1 million in 1968.

The Executive Directors have recommended to the Board of Governors, for action at its meeting in Washington beginning September 29, that $100 million of the year's net income be transferred as a grant to the Bank's affiliate, the International Development Association. The remaining portion of the year's earnings, $71.4 million, will be transferred to the Bank's Supplemental Reserve, increasing this Reserve to $1,034.3 million. Total reserves, including the Special Reserve, will amount to $1,326 million.

During the year, the Bank made 84 loans in 44 countries totaling $1,399 million, compared with a total of $847 million last year. The loans were made in Argentina (2 loans), Brazil (3), Cameroon (2), Ceylon, Chile, Republic of China (2), Colombia (6), Cyprus, Ecuador, El Salvador, Ethiopia (2), Finland, Gabon, Ghana, Guatemala, Guinea, Guyana (2), India (2), Iran (2), Ireland, Ivory Coast (3), Jamaica, Korea (2), Liberia, Malagasy Republic (2), Malaysia (4), Mexico, Morocco, Nigeria (2), Pakistan (6), Paraguay, Philippines, Senegal, Sierra Leone, Singapore (2), Sudan, Tanzania, Thailand, Trinidad and Tobago (2), Tunisia (4), Turkey (4), Venezuela (2), Yugoslavia (2) and Zambia (4). This brought the total number of loans to 636 (including $100 million to the International Finance Corporation) in 86 countries and territories and raised the gross total of commitments to $12,917 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 $8,621 million.

Disbursements on loans were $762 million, compared with $772 million in the preceding year. Cumulative disbursements amounted to $9,583 million on June 30, 1969.

During the year the Bank sold or agreed to sell $35 million principal amounts of loans, compared with sales of $107 million last year. On June

30, the total of such sales was $2,177 million, of which all except $69 million had been made without the Bank's guarantee.

Repayments of principal received by the Bank during the year amounted to $298 million, and repayments to purchasers of parts of loans amounted to $105 million. Total principal repayments amounted to $3,321 million on June 30, consisting of $1,798 million repaid to the Bank and $1,523 million repaid to purchasers of borrowers' obligations sold by the Bank.

On June 30, the outstanding funded debt of the Bank was $4,081 million, reflecting a net increase of $791.6 million in the past year. During the year the funded debt was increased through the public sale of $250 million of U.S. dollar bonds of which $70.9 million were sold under delayed delivery arrangements, SwF80 million (US$18.6 million) of Swiss franc bonds, DM650 million (US$162.5 million) of Deutsche mark bonds, KD15 million (US$42 million) of Kuwaiti dinar bonds; the private placement of bonds and notes of $352.2 million of which $15 million was sold under delayed delivery arrangements, and DM1,594 million (US$398.5 million); and the issuance of $179.5 million of bonds under delayed delivery arrangements. The debt was decreased through the retirement of bonds and notes of $330 million, DM324 million (US$81 million), BF 500 million (US$10 million), Can$16.7 million (US$15.4 million) and SwF150.6 million (US$35.1 million), and by purchase and sinking fund transactions amounting to $54.3 million.

During the year Botswana, Lesotho and Mauritius became members of the Bank and the following five countries increased their subscriptions to the Bank's capital: Trinidad and Tobago, Cyprus, Tunisia, Ghana and Burma. Thus on June 30, 1969, there were 110 member countries and the subscribed capital of the Bank amounted to $23,036.4 million.

Inter-American Development Bank

The Inter-American Development Bank Act, which authorizes the United States to participate in the Inter-American Development Bank, provides an exemption for certain securities which may be issued 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 following summary of the Bank's activities reflects information submitted by the Bank to the Commission.

During the year ended June 30, 1969, the Bank made 16 loans totaling the equivalent of $178,840,000 from its ordinary capital resources, bringing the net total of loan commitments outstanding, after cancellations, to 172, aggregating $1,098,575,000. During the year, the Bank sold or agreed to sell $8,398,078 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, Colombia, Mexico, Nicaragua, Uruguay and Venezuela.

During the year the Bank also made 42 loans totaling the equivalent of $324,850,000 from its Fund for Special Operations, bringing the gross total of loan commitments outstanding to 219, aggregating $1,358,513,000. 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 116, aggregating $497,457,000.

On June 30, 1969, the outstanding funded debt of the ordinary capital resources of the Bank was the equivalent of $714,071,000, reflecting a net increase in the past year of the equivalent of $206, 642,000. During the year the funded debt was increased through public bond issues in Germany, the Netherlands, Switzerland, Austria and Italy of DM100,000,000 (US$25million), F 30,000,000 (US$8,287, 000), SwF60,000,000 (US$13,721,000), As 150,000,000 (US$5,769, 000) and Lit 15,000,000,000 (US$24 million), respectively, as well as a public offering in the United States of $70 million of bonds, private placements of bonds and notes of $33,450,000, DM220,000,000 (US$55 million) and Swedish kronor 32,000,000 (US$6,186,000) and drawings under loan agreements with the Export-Import Bank of Japan of the equivalent of $1,879,000 in Japanese yen. The funded debt was decreased through the retirement of $31,650,000 of short-term dollar bonds and $5 million through sinking fund purchases.

The subscribed ordinary capital of the Bank on June 30, 1969, was the equivalent of $2,263,735,000 of which $1,878,015,000 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 has adopted Regulation AD which requires the Bank to file with the Commission substantially the same information, documents and reports as are required from those Banks.

During the fiscal year 1969 the Asian Development Bank approved 11 loans amounting to $71.4 million, equivalent from its Ordinary Capital resources. This brought the Bank's loans from Ordinary Capital resources as of June 30, 1969, to a total of 13 amounting to the equivalent of $76.4 million, against which disbursements of $4.37 million had been made. In addition, the Bank approved its first loan from Special Funds resources in June 1969-a loan of $990,000 equivalent to Indonesia for an irrigation project in Central Java. As of June 30, 1969, the Bank had approved 15 technical assistance projects in eight countries at an estimated cost of $2.1 million.

On March 27, 1969, Hong Kong was accepted as a member of the Bank, subscribing to $8 million of stock. This raised the total subscriptions to $978 million and brought the total membership to 33, of which 20 are countries of the region and 13 are nonregional developed countries.

The third of the United States' five $20 million installments on its paid-in capital subscription was paid during the fiscal year, and consisted of $10 million in cash and $10 million in the form of a noninterest-bearing letter of credit which may be drawn on in the future when required by the Bank for disbursement. Of the $489 million subscriptions on paid-in capital, installments totalling $291.5 million had matured as of June 30, 1969.

In September 1968 the Bank's Board of Directors formally established the "Consolidated Special Funds" of the Bank and adopted the "Special Funds Rules and Regulations" which constitute a framework for the administration of such Special Funds. Japan, Canada, Denmark and the Netherlands have offered to contribute a total of $128.1 million to the Bank's Consolidated Special Funds, $33.1 million of which had been made available to the Bank as of June 30, 1969. In his Message on Foreign Aid of May 28, 1969, President Nixon expressed his intention to submit to the Congress a new proposal for a U.S. contribution to the Bank's Consolidated Special Funds.

At the Bank's Second Annual Meeting, held in Sydney, Australia, April 10-12, 1969, the Board of Governors set aside for Special Funds operations 10 percent of the convertible currency portion of the Bank's paid-in capital which had been paid by the members as of that date ($14,575 million).

As of June 30, 1969, Canada, Denmark, Japan and the United States had agreed to contribute a total of $1.98 million to the Bank for technical assistance, against which disbursements totalling $382,149 had been made. In addition, Finland, Germany and the U.K. agreed to contribute unspecified amounts for technical assistance; as of June 30, 1969, the Bank had disbursed $60,264 from these contributions.

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 duty 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 significant responsibilities with respect to the securities markets and persons engaged in the securities business. Among other things, it requires securities exchanges to register with the Commission and provides for Commission supervision of the self-regulatory responsibilities conferred on registered exchanges. The Act also provides for the registration and regulation of brokers and dealers doing business in the over-the-counter markets, and grants to registered associations of brokers or dealers self-regulatory functions under Commission supervision. In addition, it contains provisions designed to prevent fraudulent, deceptive, and manipulative acts and practices on the exchanges and in the over-the-counter markets.

This and the next part of the report deal with developments and actions taken in these areas during the 1969 fiscal year. Statistical information concerning the securities markets is presented in this part. Certain recent developments of particular significance 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, 1969, 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

The Commission's staff has under consideration the details of a proposed acquisition of the Pittsburgh Stock Exchange by the Philadelphia-Baltimore-Washington Stock Exchange. Under the Act, the former exchange will be required to withdraw its registration as a national securities exchange and the latter will have to amend its registration statement to reflect the acquisition. In addition, particular attention is being given to the numerous rule changes which must necessarily accompany such a reorganization. [Footnote: On

December 24, 1969, the Commission issued an order granting the application of the Pittsburgh Stock Exchange for withdrawal of its registration by reason of its being merged into the Philadelphia-Baltimore-Washington Stock Exchange, and declaring the latter's acquisition of the Pittsburgh Exchange effective December 30, 1969.]

The Philadelphia-Baltimore-Washington Stock Exchange has entered into an associate membership agreement with the Cincinnati Stock Exchange. This agreement, which became operative on October 15, 1969, enables a member of either exchange to obtain associate membership on the other exchange and thereupon to have orders executed at preferred commission rates. The Philadelphia-Baltimore-Washington Stock Exchange has similar trading arrangements with the Pittsburgh, Boston and Montreal Stock Exchanges.

As of the end of the fiscal year, two exchanges, the Honolulu Stock Exchange and the Richmond Stock Exchange, were exempted from registration. In June 1969, the Commission issued an order withdrawing its exemption from registration of the International Stock Exchange (formerly the Colorado Springs Stock Exchange).2 The exemption order, which had been granted in 1936, provided that after appropriate notice and opportunity for hearing, the exemption might be withdrawn if the Commission subsequently found registration to be necessary or appropriate in the public interest. By 1967 the Exchange had become defunct, and the Commission was thereafter advised that new management had been appointed and that a reorganization was planned, including marked changes in operations, membership, securities to be listed and location. In the course of discussions between the Exchange's new management and the Commission's staff regarding these developments, the Exchange consented to the issuance of an order vacating the exemption.

Review of Exchange Rules and Procedures

A major aspect of the Commission's supervisory function with respect to national securities exchanges is the continuous review by its Division of Trading and Markets of the existing rules, regulations, procedures, forms, and practices of all exchanges. Such review is necessary in order to: (1) ascertain the effectiveness of the application and enforcement by the exchanges of their rules; (2) determine the adequacy of exchange rules and of related statutory provisions and rules administered by the Commission in light of changing market conditions; and (3) anticipate and define problem areas so that members of the Commission's staff can meet with exchange representatives to work out salutary procedures within the framework of cooperative regulation. In addition, Rule 17a-8 under the Exchange Act provides that each national securities exchange must file with the Commission a report of any proposed amendment or repeal of, or addition to, 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 Branch of Regulation and Inspections of the Division of Trading and Markets.

During the 1969 fiscal year, 96 changes in exchange rules and practices were submitted to the Commission pursuant to Rule 17a-8. Among the more significant were:

1. Amendments of the New York Stock Exchange Constitution and Rules providing for greater disciplinary jurisdiction and increasing the maximum fine which can be imposed by the Exchange against a member, allied member, member firm, or member corporation.

2. Revisions in the New York Stock Exchange's delisting criteria under which the common stock of a company may be delisted when that company or a parent or subsidiary thereof issues a debt security without sufficient earnings to cover the interest charges on all outstanding debt and when, on a pro forma basis, common stock equity is less than 25 percent of the capitalization. The criteria with regard to preferred stock and guaranteed railroad stock or similar issues were also revised.

3. Amendments to the American Stock Exchange Constitution establishing a special trust fund to provide assistance to customers threatened with loss of money or securities due to the insolvency of a member, member firm, or member corporation.

4. Changes in the policies of the Midwest Stock Exchange to require greater disclosure of certain information to the public where a stock is to be listed,

and to require delisting when the volume of trading in a particular stock declines to a specified level.

5. A new rule of the Boston Stock Exchange requiring each member, member firm, and member corporation doing business with the public to carry fidelity bonds.

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 stricken from listing and registration upon application by an exchange, or withdrawn from listing and registration upon applicaton by an issuer, 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, 1969, the Commission granted applications for the removal of 109 stock issues, representing 95 issuers, and 5 bond issues from listing and registration. Since 6 stocks were each delisted by two exchanges and-1 stock by three exchanges, the total of stock removals was 117. The distribution of these removals among exchanges was as follows:

[table omitted]

Delisting applications by exchanges are generally based on the ground that continued listing is no longer appropriate because of a reduced number of shares of the issue in public hands or an insufficient number of shareholders; the low market value of outstanding shares; insufficient trading volume on the exchange; failure to meet the exchange's requirements as to earnings or financial condition; failure to file required reports with the exchange; cessation of operations by the issuer; or a combination of these factors.

The great increase in the number of delistings by the New York Stock Exchange over the previous year, when it delisted 22 stock issues, is largely attributable to the revision in the Exchange's criteria under which preferred stock may now be delisted when there are less than 50,000 publicly held shares, or when the aggregate market value of publicly held preferred shares is less than $1 million.

The three applications by issuers which were granted during the year resulted in the removal of one security from the American Stock Exchange and two securities from the Richmond Stock Exchange.

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. This inspection program provides a means of ensuring exchange compliance with regulatory responsibilities and enables the Commission to recommend, where appropriate, 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 Com-' mission'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, 1969, 5,047 stock and bond issues, representing 2,880 issuers, were admitted to trading on securities exchanges in the United States. Of these, 4,880 securities issues (3,238 stock issues and 1,642 bond issues), representing 2,764 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 1,773 stock issues and 1,450 bond issues, representing 1,528 issuers, listed and registered on the New York Stock Exchange. Thus, with reference to listed and registered securities, 53.1 percent of the issuers, 54.8 percent of the stock issues and 88.3 percent of the bond issues were on the New York Stock Exchange.

During the 1969 fiscal year, 337 issuers listed and registered securities on a national securities exchange for the first time, while the registration of all securities of 207 issuers was terminated. A total of 765 applications for registration of securities on exchanges was filed.

Market Value of Securities Available for Trading

As of December 31, 1968, the market value of stocks and bonds admitted to trading on U.S. stock exchanges was approximately $883 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 table exclude issues suspended from trading and a few inactively traded issues for which quotations were not available.

[table omitted]

The 3,230 common and preferred stock issues represented over 15.4 billion shares.

The New York Stock Exchange has reported aggregate market value 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 since 1948. The available data since 1936 appear in Table 5 in the appendix of this report. 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 1968 was 5.4 billion shares, including stocks, rights and warrants, and $5.5 billion principal amount of bonds. The 1968 total dollar volume of all issues traded was $203 billion. Trading in stocks increased 18 percent in share volume and 22 percent in dollar volume over 1967. During the first 6 months of 1969, however, volume declined to some extent from the 1968 pace.

The figures below show the volume and value of securities traded on all stock exchanges (registered and exempted) during the calendar year 1968, and the first 6 months of 1969. Tables 6 and 7 in the appendix of this report contain more comprehensive statistics on volume, by exchanges.

[table omitted]

Foreign Stocks on Exchanges

The estimated market value on December 31, 1968, of all shares and certificates representing foreign stocks on U.S. stock exchanges was $24.7 billion, of which $19.8 billion represented Canadian and $4.9 billion represented other foreign stocks.

[table omitted]

The number of foreign stocks on the exchanges declined during calendar year 1968 from 128 to 115, continuing the general decline which 1960 when there were 173 foreign issues being traded at year-end. Trading in foreign stocks on the American Stock Exchange fell from 11.59 percent of aggregate share volume on that exchange in 1967 to 10.02 percent in 1968. Similarly, on the New York Stock Exchange, trading in foreign stocks declined from 2.6 percent of share volume in 1967 to 2.4 percent in 1968. The New York Stock Exchange has indicated that this continuing drop is due in part to the Interest Equalization Tax.

Comparative Exchange Statistics

During fiscal year 1969, there was a moderate increase in the total number of stocks listed on exchanges. Although the increase in listings on the New York and American Stock Exchanges was consistent with the trend of recent years, the increase in stocks listed exclusively on other exchanges was a reversal of the downward trend that had prevailed for many years.

[table omitted]

The aggregate value of shares listed on the New York Stock Exchange relative to the total share value on all exchanges declined for the second consecutive year in 1968. The percentage of the total share value accounted for by American Stock Exchange stocks rose for the second consecutive year, while the percentage for stocks traded exclusively on other exchanges increased for the first time since 1961.

[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 1968, both share and dollar volume continued their steady climb of the preceding 5 years and reached new peaks. Trading was particularly active on the American Stock Exchange with share and dollar volume on that Exchange increasing 22 and 51 percent, respectively, over the previous year. While volume on both the New York and American Stock Exchanges receded to some extent from the record 1968 rate during the first 6 months of 1969, volume on the regional exchanges was moderately larger.

[table omitted]

The ratio of share volume on the New York Stock Exchange to the total on all exchanges again declined in 1968, but its dollar volume ratio experienced an even steeper decline. The share volume ratio of the American Stock Exchange increased moderately last year, while its dollar volume ratio rose markedly. 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 increased moderately in 1968. In the first 6 months of 1969, both the share volume and dollar volume ratios for the New York Stock Exchange declined slightly further, while these ratios for the American and regional stock exchanges rose. Stocks, rights and warrants are included in the following presentation.

[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 174 secondary distributions in 1968 compared to 143 in the preceding year. The dollar value of the shares sold in this manner increased 36 percent to $1,571.6 million. During the first 6 months of 1969, there were 88 secondary distributions with a total value of $718.7 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. There was one special offering in 1968, the first one since 1962. Exchange distributions continued to decline from the record of 72 in 1963 to 35 in 1968. The value of the 1968 exchange distributions fell one-fourth to $93.5 million.

[table omitted]

Unlisted Trading Privileges on Exchanges

The number of stocks with unlisted trading privileges which are not listed and registered on other exchanges further declined during the fiscal year, from 97 to 89. The decline was accounted for by five American Stock Exchange stocks, two stocks traded on the Honolulu Stock Exchange and one on the Salt Lake Stock Exchange. During the calendar year 1968, the reported volume of trading on the exchanges in stocks with only unlisted trading privileges increased to about 52,321,064 shares, or about 0.98 percent of the total share volume on all exchanges, from about 38,065,577 shares, or about 0.85 percent of share volume during calendar year 1967. About 96 percent of the 1968 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 3.2 percent of the total share volume on that exchange.

Unlisted trading privileges on exchanges in stocks listed and registered on other exchanges numbered 2,018 as of June 30, 1969. The volume of trading in these stocks for the calendar year 1968 was reported at about 178,172,008 shares. About 78.6 percent of this volume was on regional exchanges in stocks listed on the New York or American Stock Exchanges. The remaining 21.4 percent represented unlisted trading on the American Stock Exchange in issues which were listed on regional exchanges but as to which the primary market was the American Stock Exchange. While the 178,172,008 shares amounted to only 3.4 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 61.4 percent; Boston 82.8 percent; Detroit 65.6 percent; Philadelphia-Baltimore-Washington 79.4 percent; Pittsburgh 55.4 percent; Midwest 29.3 percent; and Pacific Coast 29.9 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, 1969, 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 1968, total over-the-counter sales of common stocks listed on the New York Stock Exchange rose to 119.7 million shares valued at $5,983 million. This dollar volume amounted to 4.2 percent of the dollar volume in common and preferred issues on the Exchange, the highest ratio since figures first became available.

In the first half of 1969, third market volume continued to increase at a greater rate than Exchange volume. Consequently, the over-the-counter dollar volume in New York Stock Exchange common stocks rose to a record high of 4.9 percent of the dollar volume 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 1969 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. Summary statistics for the years 1935-69 are given in Appendix Table 1 and detailed statistics for the fiscal year 1969 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 issues 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 and net investment in tangible 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 non-life 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

The Commission has completed 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 notation 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 flotation 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 previous study covering the years 1951, 1953 and 1955. The current study, however, is broader in coverage and more comprehensive in its analysis. For example, the study covers all types of securities which represent ownership interests in a business or which are convertible into or represent a call on such securities. Costs were 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 covers 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 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 the means of interstate commerce in the conduct of an over-the-counter securities business to register with the Commission. Similarly, investment advisers (with certain exceptions) must register under 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.

As of June 30, 1969, 4,793 broker-dealers and 2,476 investment advisers were registered, reflecting substantial increases in both categories during the year.

The following tabulation reflects various data with respect to registrations of brokers and dealers and investment advisers during the 1969 fiscal year:

[table omitted]

During the fiscal year, the Commission amended Forms BD and ADV, the forms of application for registration as a broker-dealer and investment adviser, respectively, or for amending such application.

These forms required, among other things, that corporate applicants and registrants submit certain descriptive data about their officers, directors, and any other person who owned shares of any class of equity security of the applicant or registrant, no matter how small his holding. The Commission was advised of the difficulty being encountered by publicly held broker-dealers and investment advisers in attempting to comply with this requirement. Accordingly, the Commission amended the forms so as to require the listing only of those persons who own at least 1 percent of the authorized shares of any class of equity security of the applicant or registrant, and the furnishing of information as to business, background, education, and other pertinent facts only as to those stockholders who own at least 10 percent of any class of equity security.

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. It also 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, as a consequence of the acute delivery backlogs confronting the securities industry and the attendant strain on the financial condition of many broker-dealers, amended the net capital rule to require, in the computation of net capital, certain deductions for "failed to deliver" securities. The Commission noted that delays in deliveries of securities to customers by selling broker-dealers were in large part a reflection of the failure of other brokers and dealers to deliver those securities to the selling broker-dealers. It further noted that the great length of time in which amounts due are carried in the "failed to deliver" accounts of broker-dealers exposes them to undue risk of market fluctuations in the securities as well as to the possibility of financial difficulties of the broker on the other side of the transaction. Under the amendment a broker or dealer, in computing his net capital, must deduct amounts equal to specified percentages of the contract prices of securities in the "failed to deliver" account, in accordance with a formula based on the age of the items in the account.

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 4,369 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.

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

Under the Exchange Act, as amended in 1964, the Commission has the responsibility of establishing and administering rules relating to qualification standards and business conduct of broker-dealers who are not members of the National Association of Securities Dealers, Inc. (NASD) [Footnote: The Act does not specifically refer to the NASD, but to broker-dealers who are not members of a registered "securities association." However, the NASD is the only such association.] and persons associated with them, so as to provide regulation for these "nonmember" broker-dealers (sometimes also referred to as SECO broker-dealers) comparable to that provided by the NASD for its members. Prior annual reports have described the various rules adopted by the Commission since 1964 in the development of its regulatory program for nonmember broker-dealers.

During the fiscal year, the number of nonmember broker-dealers decreased from 495 to 455, and the number of associated persons (which includes principally partners, officers, directors, and employees not engaged in merely clerical or ministerial functions) decreased from about 20,000 to about 19,750.

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

[table omitted]

One of the requirements applicable to nonmember broker-dealers is that each associated person engaged in specified securities activities successfully complete the Commission's General Securities Examination or an examination deemed by the Commission to be a satisfactory alternative. Such alternative examinations include, thus far, those given by the NASD, by certain of the national securities exchanges, by many States, and by the National Association of Insurance Commissioners (NAIC). However, successful completion of the NAIC examination by an associated person qualifies him to sell variable annuities only. During the fiscal year 1969, 1,924 associated persons successfully completed the Commission's examination and 5,807 others an acceptable alternative examination.

Rule 15b9-2 provides for the annual fees to be paid by nonmember broker-dealers to defray the costs of regulation. These include a base fee, a fee for each, associated person and a fee for each office maintained. During the fiscal year, the Commission amended the rule by deleting the $15,000 maximum fee previously specified, and providing that the maximum would be set each year on the form which must be filed. In addition, the amended rule provides that the maximum will include the office fees as well as the other fees. The maximum for fiscal year 1969 was set at $20,000.

Pursuant to the inspection program for nonmember broker-dealers, 25 inspections were conducted during the fiscal year. These inspections were designed to determine compliance with applicable Commission rules and to obtain information which will prove helpful in the further development of the SECO program.

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 1969 the Commission received some 12,495 complaints from investors and others relating to broker-dealers. 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 1969, 732 broker-dealer inspections and 128 investment adviser inspections were carried out. These inspections produced indications of various types of infractions, as shown below:

[table omitted]

Market Surveillance. -- 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 quotation 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 firm, 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 over-the-counter surveillance program involving the use of automated equipment to provide more efficient and comprehensive surveillance. That 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.

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 3,841 "securities violations" letters either providing or requesting information and dispatched 1,852 communications to cooperating agencies. Among other matters, information was received from several States and Canada respecting 104 criminal actions, 49 injunctive actions, 169 actions in the nature of cease and desist orders and 104 other administrative orders, such as denials, suspensions and revocations of registrations of issuers, broker-dealers and salesmen. Information was also received from the U.S. Department of Agriculture, Commodity Exchange Authority, regarding administrative actions taken against futures commission merchants and floor brokers under the Commodity Exchange Act. Actions taken during the last 10 years under that Act include 71 decisions and orders and 68 stipulations and compliances. The information received was incorporated into the Commission's records. All in all, information with respect to 5,385 persons or firms was added to the files, including information regarding 2,094 persons and firms not previously identified, and information regarding 1,161 persons and firms was removed from the files as obsolete or for other reasons. As of the end of the fiscal year, the files contained information concerning 78,256 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, 1969, the Commission issued 194 such formal orders.

The following table reflects in summarized form the investigative activities of the Commission during fiscal 1969 :

[table omitted]

In Dosek v. United States, the Court of Appeals for the Eighth Circuit, in affirming Dosek's conviction for mail and securities fraud, addressed itself to the applicability of the doctrine of Miranda v. Arizona to Commission investigations. Dosek had claimed that information obtained from him during an investigation conducted pursuant to a formal order of investigation entered by the Commission had been obtained in violation of his constitutional rights established by the Supreme Court in the Miranda case. He urged that he was entitled to be informed, in the terms specified by the Supreme Court, that he had a "right to silence," that he could refuse to surrender documents and records which had been subpoenaed, and that counsel would be appointed for him if he so desired. The court rejected these contentions, primarily on the grounds that the defendant was not "in custody" when his investigative testimony was taken and that no coercion was practiced on him. The court pointed out that Dosek was advised prior to giving any testimony that he had a right to be represented by counsel and to refuse to give testimony which might tend to incriminate him.

Enforcement of Investigative Subpoenas. -- In S.E.C. v. Wall Street Transcript Corp., the district court denied enforcement of an administrative subpoena duces tecum issued in the course of an investigation under the Investment Advisers Act into the question whether the Wall Street Transcript Corporation, by publishing the Wall Street Transcript, was an unregistered investment adviser. The court distinguished a long line of cases holding that a court in a subpoena enforcement action is not to determine whether the subject of the investigation is covered by the statute, on the ground that the First Amendment was not in issue in those cases. Reasoning that "the Commission's broad inquiry under the Act can end only in restraint of expression by the Wall Street Transcript," the court concluded that it was empowered in these unusual circumstances to decide whether the subject of the Commission's investigation was covered by the Investment Advisers Act. The Commission had argued that a determination whether the Transcript was a bona fide newspaper or financial publication, and thus excluded from the coverage of the Act, must necessarily await the results of an investigation and that the question was to be determined in the first instance by the Commission rather than by the court.

Having concluded that it had jurisdiction to decide the issue, the court reviewed the publication and its advertisements and concluded that it was a bona fide financial publication of general and regular circulation which was excluded from the coverage of the Act by Section 202 (d). The court, however, specifically indicated that

"[a]n entirely different question would be presented if the SEC had complaints or other evidence of conduct by the publisher outside the normal functions of compiling and distributing an excluded publication. In [that] situation, I believe that the Commission should be entitled to proceed with court assistance under Section 209 if necessary, provided, of course, that the scope and particulars of the subpoena were not unreasonable or oppressive."

A motion by the Commission for reargument or clarification was denied by the court and the Commission filed an appeal which is presently pending.

In another subpoena enforcement action, a Florida attorney was convicted of criminally violating Section 21 (c) of the Exchange Act by failing and refusing to testify and produce records in obedience to a Commission investigative subpoena.

Imposition of Sanctions

Where enforcement action appears appropriate, the Commission may proceed in one of several ways, although the use of one procedure does 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.

Generally speaking, the Commission may impose a sanction only if, after notice and opportunity for hearing, it finds that (1) the respondent wilfully violated any provision of the securities acts or the rules thereunder; aided and abetted such violations by others; (in the case of Exchange Act proceedings) failed reasonably to supervise another person who committed such violations; or is subject to certain disqualifications, such as a conviction or injunction relating to specified types of misconduct, and (2) a particular sanction is in the public interest.

While all respondents in broker-dealer and investment adviser proceedings are entitled to a hearing, such proceedings are frequently disposed of without hearings where respondents waive a hearing and consent to the imposition of certain sanctions or submit offers of settlement which the Commission accepts as an appropriate disposition of the proceedings. In those instances where hearings are held, the hearing officer who presides normally makes an initial decision, including an appropriate order, unless such decision is waived by the parties. If Commission review is not sought, and if the case is not called up for review on the Commission's own initiative, the initial decision becomes the final decision of the Commission and the examiner's order becomes effective.

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."

Set forth below are statistics regarding administrative proceedings pending during fiscal 1969 with respect to brokers and dealers and investment advisers.

[table omitted]

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 Armstrong, Jones and Company, the Commission, among other things, held that the Securities Act registration provisions had been violated. It found that a claimed intrastate exemption from registration was not available for a particular offering of securities because certain purchasers were in fact nominees for nonresidents and an out-of-state distribution occurred when a part of the original offering was resold by resident subscribers shortly after the Armstrong firm commenced trading in the stock. With respect to the latter point, the Commission stated that, in considering whether the firm and its principals had acted properly to limit the distribution to residents, it deemed significant the facts that the firm's president had solicited orders and indications of interest from nonresidents during the initial offering and that, at the commencement of trading, the firm's opening bid was substantially higher than the offering price, thus tending to induce residents to sell their stock and enabling the firm to resell to nonresidents.

On the basis of these violations and other serious misconduct, including the making of extravagant and unwarranted representations and price predictions to customers, failure to disclose to customers common control of the firm and the issuer whose securities were being sold, and the sending of confirmations to persons who had not agreed to purchase stock, the Commission revoked the firm's broker-dealer registration and expelled it from the Detroit Stock Exchange, barred its president from association with any broker-dealer (subject to the proviso that after a year he could, upon an appropriate showing, work for a broker-dealer in a nonsupervisory capacity), and imposed sanctions of bar and censure, respectively, against two other respondents.

In Paine, Webber, Jackson & Curtis, the Commission found that Ralph M. Klopp, a salesman for Paine, Webber, induced excessive trading in the accounts of two customers by means of false representations concerning the securities activities of another customer and that Paine, Webber and the manager of the branch office where Klopp worked had failed reasonably to supervise Klopp with a view to preventing his misconduct. Klopp falsely told the customers that another customer, a doctor, had a large account, used the services of a "Chinese chartist" and an investment adviser, and had made large profits. He offered to apprise the customers of the purported doctor's transactions so that they could duplicate them. The customers thereafter effected transactions on the basis of Klopp's statements regarding transactions by the doctor, and their trading activity increased significantly. The Commission further found that the firm's procedures were not adequate to detect excessive trading and that the firm and the branch manager did not reasonably discharge their supervisory duties.

The Commission concluded that in view of the serious nature of Klopp's violations, which persisted for over 1 year, and its finding that Klopp deceived his employer through the use of a secret account for transactions by himself and his wife, it was appropriate in the public interest to bar him from association with any broker or dealer, with the proviso that such bar would not preclude his association, after a period of 1 year, with a broker or dealer in a nonsupervisory capacity upon a showing that he would be adequately supervised. The Commission censured Paine, Webber and the branch manager, noting the improvements in supervisory procedures which had been effected since the time of the violations.

In a case involving the improper use of inside information, Van Alstyne, Noel & Co., the Commission found, on the basis of offers of settlement, that the firm and certain of its partners and employees, in connection with a prospective underwriting of the stock of Spiral Metal Company, Inc. and a private placement of that company's debentures, received nonpublic information from Spiral with respect to improved sales, earnings, productive capacity and future prospects. Thereafter they purchased Spiral stock for themselves and for customers to whom they recommended the stock, prior to the public release of the information. The Commission held that respondents' advance use in market purchases of the favorable information, which they had obtained by virtue of their special relationship with Spiral, for their own or their customers' benefit and to the detriment of public investors to whom the information was not known violated anti-fraud provisions of the Exchange Act. Pursuant to the settlement offers, the Commission suspended the firm's retail sales and over-the-counter market-making activities for a period of 20 business days and its underwriting activities for a period of 15 business days, and ordered the dissociation from the firm of its senior partner for 90 days and of the other individual respondents for 20 business days.

In another decision also involving the improper use of inside information, the Commission, pursuant to an offer of settlement, suspended the activities of the government bond department of Blyth & Company, Inc., for 15 business days and suspended the former manager of that department from association with a broker-dealer for 5 business days. Certain traders in the firm's government bond department obtained from an employee of a Federal Reserve Bank nonpublic information regarding the terms of prospective new issues of government securities and effected transactions for the firm's account in outstanding government securities before the terms of the new financing were made public. When that information was made public, it affected the market price of the outstanding securities. The Commission stated that transactions in government securities are subject to the anti-fraud provisions of Section 10 (b) of the Exchange Act and Rule 10b-5 thereunder, even though such securities are exempt from certain other requirements under the securities acts, and that the legal principles enunciated in prior court and Commission decisions relating to the improper use of inside information are no less applicable to transactions in government securities than they are to transactions in "nonexempt" securities. It further stated that

"[u]nder those principles, since it was clear to participants in the government securities markets that the material information involved here was intended to be kept nonpublic until a predetermined time and then disseminated pursuant to established official procedures, it was the duty of registrant when it obtained advance possession of such information to refrain from trading in government securities until the information had been duly made public under those procedures."

In Consumer-Investor Planning Corporation, the Commission found, pursuant to offers of settlement, that Consumer-Investor Planning Corporation (CIPCO), a registered broker-dealer and investment adviser and manager of Associated Fund Trust, a registered investment company, and two of its officers and directors violated the anti-fraud provisions of the securities laws in connection with the Fund's portfolio transactions whose execution they directed. The respondents selected brokers to execute such transactions who would "give-up" a part of their brokerage commission or confer other benefits on the respondents. The Commission, pointing out that the respondents occupied a fiduciary relationship to the Fund, held that they were required to direct the execution of portfolio transactions so as to achieve the most favorable results for the Fund and not to prefer their own interest. Instead, the Commission found, respondents engaged in "blatant trafficking of the Fund's business" and "committed themselves and the Fund to relationships that did not permit them to retain, the freedom of judgment and action that as managers they owed to the Fund." The Commission had previously issued an order accepting the settlement offers which provided for various remedial action, including suspension of CIPCO's broker-dealer registration for 45 days.

In two decisions under the Investment Advisers Act, the Commission took action with respect to misleading or deceptive advertising by investment advisers. Thus, in Dow Theory Forecasts, Inc., it found, pursuant to an offer of settlement, that Dow Theory Forecasts, Inc., a registered investment adviser, and Le Roy B. Evans, its president, published and distributed false and misleading advertisements soliciting subscriptions to registrant's advisory service. Among other things, the advertisements implied that the advisory service would provide information enabling a subscriber to obtain immediate profits or to be protected against losses; implied that the Dow Theory, which is a method for ascertaining market trends, was the principal basis for registrant's selection of individual securities to be bought, sold or held; and made misleading comparisons between the methods used by registrant and by other advisers. In summing up, the Commission stated that investment advisory advertisements

"should fairly present the services that are being offered and should not be couched in terms that appeal to the investor's quest for instant riches or fear of impoverishment. Registrant's advertisements were deceptive in content and dramatic in their tone and form of presentation, particularly in the wording, size, and color of their headlines. They were obviously of a character to whet the appetite of the gullible and the unsophisticated and disregarded the restraint and qualification that the intricate and complicated nature of securities requires."

In an order previously issued, the Commission, as provided in the settlement offer, suspended all advertising and solicitation for new subscribers by the registrant for 120 days.

In Stanford Investment Management, Inc., advertising material published by an adviser whose business included the management of accounts in which clients wrote put and call options was found to be misleading. The Commission held that a brochure soliciting persons to use the adviser's management service gave a misleading impression of the probability of gains to be achieved in the sale of puts and calls under the adviser's guidance and of the unlikelihood of losses. The Commission emphasized, as it had on prior occasions, that "advertising and sales practices which may or may not be suitable for products which are subject to actual inspection and testing in use clearly have no place in the sale of securities which are goods of an intricate, complicated and intangible nature. And put and call option contracts are securities of a most complicated and technical kind whose many intricacies and complex nature are not fully understood even by many persons engaged in the securities business itself, much less by the average or unsophisticated investor. Transactions involving puts and calls have substantial speculative aspects and entail significant risks of loss, and dealings in them are highly specialized and difficult. In such a field adherence to high standards of fair and accurate advertising is particularly important . . ."

Under all the circumstances, however, including the facts that the advertisement followed the general pattern of other publications relating to put and call options and had been discontinued prior to the institution of proceedings, and that this was the first occasion on which the Commission had addressed itself to advertising literature relating to puts and calls, the Commission concluded that censure of the adviser and its president (who is also a registered adviser) was an adequate sanction.

Among the court decisions reviewing Commission orders in broker-dealer proceedings the following are noteworthy:

In Nees v. S.E.C., the Court of Appeals for the Ninth Circuit affirmed an order barring the two petitioners, who were securities salesmen for Century Securities Company, from association with any broker or dealer. One of the petitioners had not actually received notice of the hearings originally held, and he claimed a denial of due process. However, the court sustained the procedure adopted by the hearing examiner by which the hearings were reopened to afford him an opportunity to confront witnesses and otherwise to respond to the evidence previously introduced against him. The court also affirmed the right of the Commission to take action against one who aids another in securities law violations, and to impose a more severe sanction than that imposed by the examiner.

In Beck v. S.E.C., the Court of Appeals for the Sixth Circuit summarily rejected the challenge of Beck, a former salesman for Commonwealth Securities Corporation, to the sufficiency of the evidence of willful violations of the anti-fraud provisions of the Securities Act and the Exchange Act found by the Commission. It also rejected his claim that he had been denied procedural due process-a claim which included an argument that the commencement of the hearing had been unreasonably delayed. The court stated, however, that it was unable to determine whether the sanction imposed on Beck (a four-month exclusion from the securities business with a requirement that his subsequent employment be in a nonsupervisory capacity) constituted an abuse of the Commission's discretion, because the Commission had failed to "articulate the reasons for the proposed sanction." Accordingly, the court remanded the case to the Commission for a disclosure of the reasons for the imposition of that sanction.

In Hanly v. S.E.C., the Court of Appeals for the Second Circuit affirmed a Commission order barring five securities salesmen from further association with a broker or dealer. The court held that there was substantial evidence to support the Commission's finding that the salesmen made affirmative misrepresentations and made recommendations without disclosing material adverse facts of which they were or should have been aware. The court emphasized that a salesman

"cannot recommend a security unless there is an adequate and reasonable basis for such recommendation. He must disclose facts which he knows and those which are reasonably ascertainable. By his recommendation he implies that a reasonable investigation has been made and that his recommendation rests on the conclusions based on such investigation. Where the salesman lacks essential information about a security, he should disclose this as well as the risks which arise from his lack of information."

Concerning the sanctions, the court stated that the Commission "clearly has the authority to increase sanctions ordered by a hearing examiner in his initial decision."

In Pennaluna & Co., Inc. v. S.E.C., the Court of Appeals for the Ninth Circuit reviewed a decision in which the Commission found violations of the registration provisions of the Securities Act and the anti-fraud and anti-manipulation provisions of that Act and of the Exchange Act. The court affirmed as to a majority of the violations, but reversed certain of the Commission's findings of violations based on the registration provisions. In light of its reversal, the court remanded the matter to the Commission for a reexamination of sanctions in the light of its ruling "and, should it so desire, for clarification of its opinion with respect to the determination upon which we reverse." The court rejected the petitioners' request for a rehearing, and a petition for a writ of certiorari has been denied by the Supreme Court.

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 or 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 by 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. 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 37 cases were referred to the Department of Justice for prosecution. As a result of these and prior referrals, 64 indictments were returned against 213 defendants, including 17 broker-dealers and broker-dealer principals and 9 broker-dealer employees. Convictions were obtained against 83 defendants in 47 cases, including 15 broker-dealers and broker-dealer principals and-3 broker-dealer employees. Convictions were affirmed in 9 cases, and appeals were still pending in 15 other criminal cases at the close of the period.

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), which is the only association registered under the Act, includes as members most of the broker-dealers who do business in the over-the-counter market or who underwrite new issues. The Act contemplates that such associations will serve as a medium for self-regulation by over-the-counter brokers and dealers. Their rules must be designed to protect investors and the public interest, to promote just and equitable principles of trade, and to meet other statutory requirements. They are to operate under the general supervision of the Commission, which is authorized to review disciplinary actions taken by them, 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 properly grant price concessions, discounts and similar allowances only to other members.

At the close of the fiscal year the NASD had 4,102 members, reflecting a net increase of 332 members during the year. This increase was the net result of 543 admissions to and 211 terminations of membership. As of the end of the year NASD member firms had 7,099 branch offices. This figure reflects a net increase of 1,154 offices during the year, resulting from the opening of 1,712 new offices and the closing of 558 offices. During the year the number of registered representatives and principals, categories which include all partners, officers, traders, salesmen and other persons employed by or affiliated with member firms in capacities which involve their doing business directly with the public, increased by 50,146 to stand at a record level of 159,029 as of June 30, 1969. This increase, which was the net result of 57,683 initial registrations, 22,355 re-registrations and 29,892 terminations of registrations, was attributable to the entry of an increased number of insurance companies into the securities business for the purpose of offering mutual funds and/or variable annuities to the investing public and to the increase in activity in the securities markets generally,

During the fiscal year the NASD administered 103,351 qualification examinations, of which approximately 71,408 were for NASD qualification and the balance to meet the requirements of other organizations or authorities, including major exchanges, the Commission and various States.

In Harwell v. Growth Programs, Inc., which principally involved the power of the NASD to act by interpretation of one of its Rules of Fair Practice, the Commission filed a brief as amicus curiae in the District Court for the Western District of Texas supporting the NASD's action. An interpretation promulgated by the Board of Governors of the NASD in 1966 stated that the speculative use of the withdrawal-and-reinstatement privilege contained in certain contractual plans for the accumulation of mutual fund shares was contrary to the public interest and inconsistent with Article III, Section 1 of the NASD Rules of Fair Practice, which requires NASD members to conduct their business in accordance with "high standards of commercial honor and just and equitable principles of trade." The plaintiffs, who were purchasers of single-payment contractual plans containing the withdrawal-and-reinstatement privilege, sued the NASD, among others, seeking damages and the resumption of the right to unlimited exercise of that privilege, alleging both breach of contract and violations of the Federal anti-trust laws. The Commission, in its brief, took the position that contracts entered into by others with members of a registered securities association, such as the NASD, must be deemed subject to the rules of such association and to any duly adopted interpretations thereof-in order to achieve the effective self-regulation of broker-dealers intended by the Securities Exchange Act. The Commission also urged that collective action under Commission supervision by the NASD and its members in promulgating new rules or new interpretations of existing rules and in enforcing those rulings is clearly contemplated under that Act and cannot without more constitute a violation of the anti-trust laws.

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 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, five NASD disciplinary decisions were pending before the Commission on review. During the year five additional cases were brought up for review. Seven cases were disposed of by the Commission. In five of these cases, the Commission sustained in full the disciplinary action taken by the NASD. In one case the Commission modified the penalties 3S and in the seventh case the review proceedings were discontinued upon request of the applicants. Three cases were pending at 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, five applications for approval of admission to or continuance in membership were pending. During the year, four additional applications were filed, six were approved, one was remanded to the NASD and one was withdrawn, leaving one application pending at the year's end.

Commission Inspections of the NASD. -- Under the regulatory scheme of the Exchange Act the Commission, as noted, is charged with general oversight of national securities associations in the performance of their self-regulatory activities. With a view to insuring that the NASD is meeting its responsibilities, the Commission's staff conducts periodic inspections of various phases of NASD activity. During the past fiscal year, the staff inspected the entire operation of the Association's district office in New York City. This is the largest NASD district from the standpoint of number of members (1,463) and associated personnel (35,069).

Disciplinary Actions 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 of any rule or regulation thereunder.

During the fiscal year, nine exchanges reported approximately 136 separate actions, including impositions of fines in 72 cases ranging from $50 to $100,000, with total fines aggregating $693,510; the suspension from membership of 31 individuals; and the censure of 26 member firms. These exchanges also reported the imposition of various sanctions against 58 registered representatives and employees of member firms. In addition the American Stock Exchange reported a number of informal staff actions of a cautionary nature. Many of the actions against members and member firms resulted from back-office and other operational difficulties.

VIOLATIONS OF ANTI-FRAUD OR RELATED PROVISIONS -- CIVIL AND CRIMINAL PROCEEDINGS

A substantial proportion of the Commission's enforcement actions is concerned with the use of false or misleading representations in connection with the sale or purchase of securities or other conduct violative of the anti-fraud or anti-manipulative provisions of the Securities Act or Securities Exchange Act. Action designed to deal with such practices often takes the form of injunctive suits or referral to the Department of Justice for criminal prosecution. 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, such participation is in the appellate courts. This section of the annual report summarizes some of the more noteworthy civil and criminal proceedings involving-matters in the areas described above, as well as some involving certain other provisions of the 1933 and 1934 acts.

Civil Litigation

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 S.E.C. v. Texas Gulf Sulphur Co., as previously reported, the Court of Appeals for the Second Circuit reversed a decision of the district court and held that certain corporate "insiders" had violated Section 10 (b) of the Exchange Act and Rule 10b-5 under that Act by purchasing stock of Texas Gulf on the basis of material inside information not known, to the general public. On April 21, 1969, the United States Supreme Court denied petitions for writs of certiorari filed by two of the defendants, Frances G. Coates and Harold B. Kline. Mr. Coates was a director of Texas Gulf who purchased Texas Gulf stock after the company, at a specially called press conference, had announced a major ore discovery near Timmins, Ontario, Canada, but before that announcement had appeared in any news medium of widespread circulation. Mr. Kline was an officer of Texas Gulf who accepted a stock option from the company without disclosing to the directors who granted the option information he knew concerning the company's mining activities near Timmins. The case has been returned to the trial court for further findings with respect to a press release issued by Texas Gulf which the Commission charges was misleading, and for a determination of the remedies to which the Commission is entitled as against all the defendants.

After the close of the fiscal year, Mr. Coates and the Commission settled their litigation. By the terms of the settlement, which was approved by the district court, Mr. Coates has paid to Texas Gulf $26,250, which represents the difference between the price of Texas Gulf common stock purchased by Mr. Coates and his "tippees" on April 16, 1964, and the mean price of that stock on the New York Stock Exchange on April 17, 1964. Pursuant to the terms of the settlement, the company is to hold the money until the court orders its disposition; in the absence of such an order, the money is to become the property of the company.

In an amicus curiae brief filed at the behest of the court in Cannon v. Texas Gulf Sulphur Co., the Commission supported 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 a class of investors to the fullest possible extent. The Commission's views were similar to those expressed in Hohmann v. Packard Instrument Go, and Doglow v. Anderson, reported in the 34th Annual Report at pages 103-104. The court's decision in the Cannon case was consistent with the views expressed by the Commission.

In Heit v. Weitzen, as previously reported, the Court of Appeals for the Second Circuit agreed with a position taken by the Commission, amicus curiae, concerning the scope of the "in connection with" clause of Section 10 (b) of the Exchange Act and Rule 10b-5 thereunder. The court found that language sufficiently broad 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 actual trading by the corporation or those connected with the issuance of the statement and irrespective of the absence of motive to affect the market. After the filing of a petition for a writ of certiorari, and the filing of a brief in opposition, the Supreme Court invited the United States to express its views. The Commission and the Department of Justice filed a brief in response to this invitation, expressing the view that the decision of the court of appeals was correct and that review by the Supreme Court was not required. On May 19, 1969, the Supreme Court denied the petition.

In Schoenbaum v. Firstbrook, the Court of Appeals for the Second Circuit sitting en bane followed the ultimate recommendations of the Commission, contained in its brief amicus curiae. in an action under Section 10 (b) of the Exchange Act and Rule 10b-5 thereunder. The suit was a derivative action brought by an American shareholder of Banff Oil Ltd., a Canadian corporation that conducts all of its business operations in Canada although its common stock is registered with the Commission and traded on the American Stock Exchange as well as the Toronto Stock Exchange. The complaint alleged violations of Section 10 (b) and Rule 10b-5 based on sales of Banff treasury stock to Aquitaine Company of Canada, Ltd., a Canadian corporation which controlled Banff, and to another corporation. These sales were at the current market price, but it was alleged that they were far below actual value since they did not reflect the value of a rich oil strike in which Banff had an interest. All of the directors of Banff were aware of the oil discovery but the news had not yet been disclosed to the public. Defendants were Aquitaine, the other corporations and all directors of Banff.

As to the Aquitaine transaction the court held that the complaint stated a cause of action under Section 10 (b) and Rule 10b-5 because:

"It is alleged that Aquitaine exercised a controlling influence over the issuance to it of treasury stock of Banff for a wholly inadequate consideration. If it is established that the transaction took place as alleged it constituted a violation of Rule 10b-5, subdivision (3) because Aquitaine engaged in an 'act, practice or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.' Moreover, Aquitaine and the directors of Banff were guilty of deceiving the stockholders of Banff (other than Aquitaine)."

This holding required a reversal of the district court which had been affirmed by a panel of the court of appeals. The reasoning below was that there was no violation of the anti-fraud provisions because all of the Banff directors knew the relevant facts at the time of the transaction, those who were directors of both Aquitaine and Banff, and were thus subject to a conflict of interest, had refrained from voting, and there was no showing why the knowledge of its directors should not be imputed to Banff. The full court also held that the allegations of the complaint were sufficient to withstand a motion for summary judgment when supported by affidavits demonstrating little more than Aquitaine's controlling shareholdings in Banff, its possession of material inside information about an oil discovery and the difference between the price at which the stock was sold and its market price after the news had been released.

Three judges dissented, adhering to the views expressed in the majority opinion of the panel. In their view, the majority opinion of the full court "does indeed open the floodgates" and is "nothing short of a standing invitation to blackmail and extortion."

No review had been sought of the panel's decision that the fact that the sales in question took place in Canada between foreign buyers and sellers did not deprive the court of subject matter jurisdiction under Section 30 (b) of the Exchange Act.

The past two annual reports discussed the amicus curiae brief filed by the Commission and the decision by the court of appeals in Pappas v. Moss, where the court held, in accordance with the views of the Commission, that a corporation may be the victim of a violation of Rule 10b-5 even though all directors know all the true facts. The case involved the issuance of common stock of the corporation to certain outsiders and to the defendant directors at a price which the court found was not fair and reasonable. The directors, who approved the transaction, were aware of the pertinent facts, and shareholder approval was not required under State law. Nevertheless, approval was sought so that the newly issued stock could be listed on the American Stock Exchange. The defendant directors owned a majority of the outstanding shares and voted them in favor of the transaction. Following remand by the court of appeals, the district court filed a supplemental opinion awarding judgment of $344,446 in favor of the corporation, against all of the defendants jointly and severally. The defendants included all of the directors of the corporation and most of its corporate officers at the time of the transaction in question. The district court found under State law that the defendants had failed to sustain their burden of proving that the entire transaction was "honest, fair and reasonable." In this connection the court found that the defendants caused the corporation to execute certain documents which were admittedly untrue and that they had misrepresented certain facts to the corporation and its shareholders. In connection with its finding of a violation of Rule 10b-5, the court stated:

"Without regard to the other misrepresentations and failures to reveal, heretofore found, the defendants caused . . . [the corporation] to sell its investment letter shares to themselves and to the outsiders at prices substantially below the fair value thereof on the dates of sale. These transactions constituted material acts, practices and a course of conduct which would operate as a fraud or deceit on the corporation (assuming the independent stockholders were standing in the place of the defrauded corporate entity as suggested by the court of appeals) in violation of subdivision (3) of Rule 10b-5."

Last year's annual report discussed the reasons for the Commission's disagreement with the decision by the Court of Appeals for the Ninth Circuit in S.E.C. v. National Securities, Inc. During the fiscal year the Supreme Court reversed the decision of the court of appeals and held, in accordance with the views expressed by the Commission, that the McCarran-Ferguson Act does not preclude the application of the anti-fraud provisions of the Securities Exchange Act to false and misleading statements made in soliciting stockholder consents to a merger of insurance companies. While recognizing that approval of insurance company mergers is a matter governed by State law, "the paramount Federal interest in protecting shareholders [was held] in this situation [to be] perfectly compatible with the paramount State interest in protecting policyholders." Since the McCarran-Ferguson Act purports to make the States supreme only with respect to laws "regulating the business of insurance," the court observed that State activity focusing upon the relationship between a stockholder and the company in which he owns stock "is not insurance regulation, but securities regulation" and thus not within the scope of the McCarran-Ferguson Act. The court also stated that, although securities regulation by the States "may co-exist" with securities regulation under the Federal securities laws, "it has never been held that State regulation of insurance securities preempts Federal regulation."

The court rejected an argument, based on the so-called "no-sale doctrine," that the complaint failed to allege misstatements "in connection with the purchase or sale of any security," as required by Section 10 (b) of the

Securities Exchange Act and Rule 10b-5 thereunder. It pointed out that the "no-sale doctrine" is specifically applicable only to cases involving the registration provisions of the Securities Act, and that, where an exchange of shares is involved, as in some merger situations, stockholders of a nonsurviving company are deemed to have " 'purchased' shares in the new company by exchanging them for their old stock." The court also held that there was no bar to the application of Rule 10b-5 to misstatements in proxy soliciting materials, stating:

"Section 10 (b) applies to all proscribed conduct in connection with a purchase or sale of any security; Section 14 applies to all proxy solicitations, whether or not in connection with a purchase or sale. The fact that there may well be some overlap is neither unusual nor unfortunate."

In Mader v. Armel, the court, following the position advocated by the Commission in a brief, amicus curiae, held that an exchange of shares by minority shareholders pursuant to a merger agreement constitutes a "purchase" and "sale" of securities and affords those shareholders standing to maintain a suit under Section 10 (b) of the Securities Exchange Act and Rule 10b-5 thereunder.

In Carroll v. First National Bank of Lincolnwood, the court agreed with the position taken by the Commission, amicus curiae, that the amended complaint stated a claim against the defendant bank for violations of Section 10 (b) of the Exchange Act and Rule 10b-5.

The complaint alleged a scheme whereby the bank would delay the payment of sight drafts for securities purchased by certain of its customers, in the hope that the price of the purchased securities would rise, und the purchase could be financed by the proceeds of the sales or pledges of the securities purchased. The court agreed that the Securities Exchange Act is not intended to provide protection only for unsophisticated investors; ruled that the bank's participation in the scheme was a sufficient connection with the fraud to satisfy the "in connection with" clause even though the bank itself neither bought nor sold securities; ruled that the bank was "any person" within the purview of Section 10 (b) and Rule 10b-5; and refused to read into Section

10 (b) and Rule 10b-5 a contributory negligence standard as the bank had urged.

Tender Offer Cases. -- The Commission during the fiscal year participated as amicus curiae in three cases involving tender offer situations.

In Electronic Specialty v. International Controls, the Commission took the position that a company that is the target of a cash tender offer has standing to sue for alleged violations of Sections 14 (d) (1) and (e) of the Exchange Act which were part of the recently enacted tender offer legislation. Its memorandum, which dealt only with the issue of standing, was submitted at the request of the district court in connection with the defendants' motion for summary judgment. The district court held, as the Commission had urged, that the target corporation did have standing to seek injunctive relief. On appeal, the Court of Appeals for the Second Circuit disagreed with the district court's finding that the complaint stated a violation of the tender offer provisions involved but agreed that the target corporation had standing. It reasoned that the purposes of the tender offer legislation would best be accomplished by allowing the target corporation to have standing since, among other things, "the superior resources of the corporation . . . can be vital in .. [the context of violations of the securities laws in the course of a tender offer] where remedial action must be speedy and forceful."

Subsequently, the Commission, in Pan American Sulphur Company v. The Susquehanna Corporation, had occasion to take exception to certain language in the court of appeals' decision in Electronic Specialty which suggested that the remedies of divestiture or disfranchisement are inappropriate for violations of the tender offer provisions. In a memorandum dealing solely with the question of appropriate remedies, the Commission stated that the opinion in that case "failed to give sufficient recognition to the principles, . . . establishing the importance of effective remedies as an enforcement weapon to deter further violations. In this connection, the court attached undue significance to the possible monetary loss to the defendant from an order of divestiture or disfranchisement." The Commission further urged that the remedy of precluding (either by injunction or divestiture) the tender offeror from exercising control over the target company through the use of the unlawfully acquired shares affords "some redress to the nontendering shareholder by preventing what may be a change in the nature of his investment that he did not desire; it also serves as a deterrent to future violations by depriving the wrongdoer of the fruits of his misconduct." The district court opinion, which enjoined the defendants from voting the shares acquired in connection with violations of the securities laws, is consistent with the views expressed by the Commission.

In a related case, Iroquois Industries, Inc. v. Syracuse China Corporation, where the alleged violations of the securities laws occurred prior to the passage of the tender offer bill, the Commission took the position in a brief submitted amicus curiae to the Court of Appeals for the Second Circuit that the corporation making a tender offer had standing to sue the target corporation for its alleged violations of Section 10 (b) of the Exchange Act and Rule 10b-5. Subsequent to the end of the fiscal year, the court affirmed the district court's dismissal of the action for lack of standing.

Criminal Proceedings

Among the important criminal prosecutions initiated during the year were several involving attempts to evade provisions of the securities laws by channeling activities through various foreign countries that have strict secrecy laws regarding financial activities. The Arzi Bank A. G. of Zurich, Switzerland, was indicted and pleaded guilty to a charge that it violated the margin rules established by the Federal Reserve Board and enforced by the Commission. The indictment charged that since 1964 the Bank had been assisting certain American investors to circumvent these requirements by permitting such investors to trade on as little as 10 percent margin through omnibus accounts maintained by the Bank at various New York Stock Exchange member firms. In a related case, Coggeshall & Hicks, a New York Stock Exchange member firm, and five of its partners and employees were indicted on charges of conspiring with the Bank to arrange illegal extensions of credit, in connection with purchases and sales of securities channeled through an omnibus account maintained with the .firm by the Bank. Three of the individual defendants pleaded guilty to the charge.

In another case involving the use of Swiss and other foreign banks to circumvent provisions of the Federal securities laws, two indictments were returned against Jerome Deutsch, executive vice-president of Kealty Equities Corporation, a diversified New York concern. The first indictment among other things charged Deutsch and Nate Dolin, an officer and director of an affiliated company, with violations of the mail fraud statute and anti-fraud provisions of the Exchange Act in connection with the sale by Realty Equities and others of promissory notes with warrants attached to Swiss banks, with undisclosed personal profits being realized by Dolin when the Swiss banks in turn resold the notes and warrants to Equity Growth Fund of America, Inc., a mutual fund. The second indictment charged Deutsch and Frank D. Mills, a former vice president of the Puritan Fund of Boston, Massachusetts, and an officer of the Fidelity Trend Fund of Boston, Massachusetts, with violations of anti-fraud provisions of the Exchange Act and the provisions of Section 17 of the Investment Company Act of 1940, which prohibit joint ventures between investment companies and their affiliates without prior Commission approval and prohibit investment company officers from receiving undisclosed compensation in transactions entered into by the investment company. The charges centered around Mills' purchase from Deutsch, for Puritan Fund and Fidelity Trend Fund, of Realty Equities promissory notes with warrants attached without prior Commission approval, and the payment of undisclosed compensation to Mills by Realty Equities and one of its officers in connection with these transactions.

The former president and chairman of the board of directors of VTR, Incorporated, whose shares are listed on the American Stock Exchange, was indicted together with a former broker-dealer, three promoters, another person associated with VTR, and a Liechtenstein trust, for conspiracy to violate, and substantive violations of, the registration and anti-fraud and antimanipulative provisions of the Securities Act and the Exchange Act in connection with a scheme to distribute unregistered VTR shares at manipulated prices, and to conceal the identity of the sellers by utilizing Swiss and German banks and a Liechtenstein trust, all operating under cover of strict secrecy laws in their respective countries. The indictment charged that simultaneously with the illegal distribution, the defendants made a world-wide effort to manipulate upward the price of VTR stock on the American Stock Exchange. One promoter and the Liechtenstein trust have pleaded guilty to the charges, and the remaining defendants are awaiting trial.

Two Canadian promoters and one English promoter, along with a Panamanian bank, and a Bahamian bank operating out of Switzerland, were indicted for conspiring to violate and substantive violations of the registration and anti-fraud provisions of the Securities Act and the Exchange Act, and the Federal mail fraud statute. The indictment charged a scheme whereby American investors were enticed by the defendants to exchange securities held in dormant or defunct Canadian mining companies for allegedly valuable new securities of a complex of companies operated by the defendants in Panama and the Bahamas. To effect such exchanges, investors were required to pay transfer fees, transfer taxes, and a supposedly due United States interest equalization tax to a bank controlled by the defendants in Panama. All of such funds were converted to the defendants' own use and benefit. This case has not been tried, since the defendants are currently either fugitives or incarcerated in other countries. Canadian Provincial authorities in Toronto, Ontario, rendered material assistance to the Commission in the development of this international securities fraud case.

Shortly after the end of the fiscal year, First Hanover Corporation, a New York Stock Exchange member firm, Alfred M. Lerner, its president, and three other defendants were indicted for conspiracy to violate, and substantive violations of, the margin requirements of Regulation T of the Federal Reserve Board and the Federal false statements statute. The indictment charged that in connection with an attempted takeover of Holly Sugar Corporation the defendants permitted another company to purchase Holly Sugar securities in an omnibus account maintained at First Hanover by a brokerage firm located in Montevideo, Uruguay, without complying with applicable margin requirements. In a second indictment, Lerner was charged with violations of the anti-fraud provisions of the Exchange Act for failure to disclose in registration statements filed with the Commission on behalf of three corporate issuers that material amounts of each issue were to be sold to a Panamanian company controlled by Lerner, and that such purchases were to be channelled through several Swiss banks and a broker-dealer located in Montevideo.

Significant indictments returned during the year in other cases included indictments charging violation of Federal Reserve Board Regulation U which regulates the amount of credit that banks can extend to finance the purchase of listed securities; violation of anti-fraud provisions by officers of a broker-dealer who allegedly failed to disclose that the firm could not promptly deliver securities being sold, because of the precarious financial condition of the firm; manipulation of the price of Rand Development Corporation stock through misleading-press releases relating to an alleged "cancer cure," in an attempt to forestall a bank from calling substantial loans secured by Rand Development stock; and violations of the registration and anti-fraud provisions of the Securities Act and the mail fraud and conspiracy statutes in connection with the sale of "bond investment certificates" and other securities of Louisiana Loan and Thrift Corporation and Arkansas Loan & Thrift Corporation.

In disposing of pretrial motions in a case that has not yet been tried, the Federal district court in the Southern District of New York held that the "short selling" provisions of Section 10 (a) of the Exchange Act and Rule 10a-1 thereunder were not unconstitutionally vague, since on their face they define a crime with sufficient precision to enable a person of common intelligence to understand the type of activity proscribed and to conduct himself within the confines of the law. In the same case, the court upheld the constitutionality of the penalty provision of Section 32 of the Exchange Act which makes the wilful violation of a rule under the Act a felony unless the defendant can prove that he had no knowledge of the rule, in which case the crime is reduced to a misdemeanor. Another district court, interpreting Section 32, held that two defendants who had pleaded guilty to violations of Rule 10b-5 in the case involving the collapse of Westec Corporation, the Texas-based conglomerate, were guilty of felonies, rejecting their claim that they were guilty only of misdemeanors since they allegedly had no actual knowledge of the specific language of Rule 10b-5.73 The court found that they knew that the Act proscribed fraud and manipulation, and held that, notwithstanding their claimed ignorance of the specific language of Rule 10b-5, such knowledge constituted sufficient criminal intent to make their activities felonious.

In United States v. Frank, involving a charge of criminal contempt based on violation of an injunction issued at the Commission's request, the U.S. Supreme Court held that it was not error for the trial court to place the defendant on probation for 3 years even though he had requested and been denied a jury trial. The Court applied the principle of Cheff v. Schnackenberg to criminal contempt cases arising out of violations of civil injunctions obtained by Commission; i.e., that the defendant is not entitled to a jury trial as long as the sentence imposed upon conviction does not exceed 6 months imprisonment.

COOPERATIVE ENFORCEMENT PROGRAM

In recent years the Commission has given increased emphasis to the coordination of its enforcement activities with those of the various State and local authorities, the self-regulatory agencies and foreign securities agencies. This program encompasses the referral to State and local authorities for investigation and criminal or other action of those violations where the amounts of money or the number of investors involved do not appear to be substantial enough to warrant development of the case at the Federal level. The Commission frequently provides manpower assistance to these authorities in the development of such cases.

During the fiscal year, the Commission continued its program of cooperative regional enforcement conferences at each of its regional offices. These conferences, during which Commission personnel meet with personnel from State securities commissions, post office inspectors, Federal, State and local prosecutors and local representatives of self-regulatory agencies such as the NASD, are designed to promote the exchange of information concerning regional enforcement problems, the development of methods of increasing cooperation and communication, and the elimination of needless effort and waste of manpower and other resources in the regulation of the securities markets. Although the Commission served as the primary agency in establishing these cooperative enforcement conferences, they have progressed to the point where State securities commissions are now often the hosts or co-hosts of the programs. In addition, the Commission's regional offices have taken steps to improve the coordination of inspections and other activities with State securities administrators and with the NASD in those areas where their respective jurisdictions overlap. Staff members of the Commission and of certain State authorities have conducted joint inspections which have made the entire inspection program more effective.

For the past 3 years the Commission has held one or two-week nation-wide enforcement training sessions at its headquarters office in Washington, D.C. to which it has invited staff members of State and foreign securities commissions. The 1969 session was attended by government officials from France, Canada, Brazil, Puerto Rico and practically every State, as well as by staff members from each of the Commission's offices throughout the country.

In September 1968, representatives of various regulatory agencies met in Philadelphia to consider problems of supervision of the operations of broker-dealers in light of the serious problems raised by the high volume of securities transactions. It was concluded that many broker-dealer managements had not used adequate supervisory procedures to cope with current selling and back office problems in any meaningful manner. As a result, a joint release was issued by the participating agencies -- the Commission, the NASD, the Philadelphia-Baltimore-Washington Stock Exchange, and the securities administrators of Maryland, Pennsylvania, Virginia and the District of Columbia -- emphasizing the responsibility of broker-dealer managements for adequate supervision so as to safeguard against improper sales practices and deficiencies in back office procedures, listing certain supervisory functions of vital concern and pointing out that noncompliance with supervisory responsibilities may lead to disciplinary action.

ENFORCEMENT PROBLEMS WITH RESPECT TO FOREIGN SECURITIES

During fiscal year 1969 the staff of the Commission, working in many instances in cooperation with foreign authorities, intensified its efforts to curb sales within the United States of foreign securities not registered under the Securities Act of 1933. Attempts to sell foreign securities in violation of the registration provisions included campaigns by mail sent from outside the United States to prospective purchasers in the United States soliciting the purchase of securities of worthless or nonexistent companies, and distributions of shares by controlling stockholders of a foreign company whose stock is listed on the American Stock Exchange. In these and other cases shares were purchased by investors in the United States without the benefit of the extensive disclosures provided by the registration and prospectus provisions of the Securities Act.

An example of the former type of operation was the mailing of a purported market letter bearing a Jamaica, West Indies, address but printed in and mailed from Toronto, Ontario, Canada, recommending shares of stock of a company called California and Caracas. This letter was sent to a list of United States shareholders of a well-known Canadian company having substantial assets. The mailing was followed by long distance telephone calls from New York City urging these shareholders to send in their shares of the Canadian company in order to exchange them for shares of California and Caracas. As a result of these activities, the Commission added California and Caracas to its Foreign Restricted List, which consists of foreign companies whose securities the Commission has reason to believe are being, or recently have been, offered for public sale and distribution in the United States in violation of the registration requirements of the Securities Act.

Another unlawful distribution involved sales of the shares of Revenue Properties Company Limited, a Canadian real estate company. As a result of the large volume of trading in Revenue Properties' stock on the American Stock Exchange and a rapid and substantial price increase, the American Stock Exchange halted trading in April 1969. The Commission subsequently instituted an action in the U.S. District Court for the Southern District of New York against the company, its controlling persons and others to enjoin further offers and sales of such stock in violation of the Securities Act. The complaint alleged among other things that controlling persons of the company had sold a large number of shares of its common stock, including some to U.S. residents, at a time when a registration statement covering other shares of the controlling persons was pending before the Commission and that the registration statement, when it became effective, failed to disclose such sales. With the defendants' consent, the court permanently enjoined them against further violations of the Securities Act's registration provisions in connection with the offer and sale of Revenue Properties shares. The Ontario Securities Commission concurrently conducted an investigation that resulted in the filing of criminal charges against the controlling persons for false statements or misleading omissions in registration statements and financial statements filed with that Commission.

In February 1969, the Commission obtained an injunction in the U.S. District Court for the Southern District of Illinois against a number of Panamanian, Bahamian and European companies, including DeVeers

Consolidated Mining Corporation S.A., and their principal promoters who were engaged in the offer and sale to American investors of unregistered securities of those companies by fraudulent means. Simultaneously with the filing of its complaint seeking an injunction, the Commission had also added to its Foreign Restricted List several of the defendant companies which were not already on the list.

At the Commission's request, the U.S. Post Office Department at various times during the past few years has issued foreign postal fraud orders against several of the companies referred to above in an effort to combat fraudulent promotions emanating from Panama and the Bahamas Islands. While such orders do not halt mail sent into the United States by foreign-based promoters, return mail from United States residents to the promoters' foreign addresses is returned to the senders stamped "Fraudulent." In this manner, the promoters are denied the fruits of their illegal schemes.

At June 30, 1969, the following 39 companies were on the Commission's Foreign Restricted List:

[table omitted]

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 investors in such 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, outright theft 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 custody of its assets; and provides specific controls designed to protect against unfair transactions between investment companies and 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, 1969, there were 1,167 investment companies registered under the Act, whose assets had an aggregate market value of approximately $72.5 billion. Compared with corresponding totals at June 30, 1968, these figures represent an over-all increase of approximately $2.7 billion, or about-4 percent, in the market value of assets and an increase of 200, or almost 20 percent, in the number of registered companies.

The following table shows the numbers and categories of registered companies and the approximate market value of the assets in each category as of June 30, 1969.

[table omitted]

The approximately $8.4 billion of assets of the registered unit investment trusts includes approximately $7.9 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 222 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 registrations.

[table omitted]

As the table shows, 20, or approximately 9 percent, of the newly registered companies were variable annuity separate accounts of insurance companies. [Footnote: The applicability of the requirements of the Investment Company Act to variable annuity contracts was discussed in prior annual reports. Typically, a variable annuity contract provides payments for life commencing on a selected date with the amounts of the payments varying with the investment performance of equity securities which are set apart by the insurance company in a separate account which is registered with the Commission as an investment company. The separate accounts now registered are either open-end management companies or unit investment trusts.] Including these companies, there were 49 active variable annuity separate accounts registered at June 30, 1969, consisting of 10 unit investment trusts and 39 management open-end investment companies. A significant part of the Commission's regulatory effort with respect to variable annuities has involved the application of the requirements of the Investment Company Act to the patterns and procedures which have grown up in the insurance industry.

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, OTHER THAN APPLICATIONS

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. Proxy soliciting material filed by investment companies is reviewed for compliance with the Commission's proxy rules. Periodic and other reports must also be filed by investment companies. The number of registration statements and proxy soliciting materials filed or processed during the fiscal year was as follows:

[table omitted]

Investment companies also filed 681 annual reports, 2,176 quarterly reports, 1,752 periodic reports to shareholders containing financial statements and 2,269 copies of sales literature. In each category of filings (except copies of sales literature), there was a substantial increase as compared to the preceding year.

Moreover, 22.5 percent more Securities Act registration statements and post-effective amendments and 66 percent more registration statements under the Investment Company Act were processed in fiscal 1969 than in the previous year.

Expedited Procedures and Registration Statement Guidelines

The increase in the number of registration statements processed, with no increase in staff personnel, may be attributed in part to the institution of certain expediting procedures and the publication of proposed guidelines on the preparation of registration statements.

On March 12, 1969, the staff announced that certain procedures designed to expedite investment company filings would be introduced. One of the major features of the expediting procedures is a check list that serves as an aid both to counsel in the preparation of registration statements and to the staff in its analysis of registration statements to determine whether only a cursory or a detailed review is necessary. The check list provides an opportunity for investment company counsel to consider in advance questions which the staff otherwise routinely raises. It also enables the staff to grant expedited treatment to those registration statements which do not raise novel or complex questions and for which clear disclosure procedures have been established. In addition, the check list may indicate to the staff that the registrant has not complied with particular regulatory provisions and that amendments are required.

In another effort to facilitate and expedite processing of filings, the staff proposed guidelines for the preparation of registration statements on Forms S-4 and S-5-4 and Form N-8B-1. They represent tentative views on matters which present recurring problems to the securities bar and the investment company industry in the preparation of registration statements; public comment on the proposed guidelines has been invited.

DEVELOPMENTS WITH RESPECT TO PARTICULAR TYPES OF INVESTMENT COMPANIES

The increase in filings under the Act has been accompanied by an increase in the variety of forms of investment companies and in the problems presented by developments in the industry.

Bank-Affiliated Investment Companies

Among the new types of companies which have filed registration statements under the Investment Company Act during the past fiscal year are various bank-affiliated investment companies.

The National Association of Mutual Savings Banks, an organization of 529 member banks in 18 States, was instrumental in the organization of one of these affiliated funds. Shares of the fund will be offered only to the depositors of mutual savings banks which have advised the Association that they wish to participate in the program, to mutual savings banks themselves or organizations controlled by such banks and to trusts of which banking organizations are trustees. Unlike the Commingled Managing Agency Account of the First National City Bank of New York, this fund has not been organized as a department of a bank and it will have an outside investment adviser which is not a bank.

Also registered during the fiscal year were two investment companies whose shares were to be offered exclusively to Ohio banks and trust companies. These companies were designed as investment vehicles for the trust accounts of those banks and trust companies whose size did not warrant the employment of a large staff of investment advisory personnel.

Investment Companies Using Leverage and Other Special Investment Techniques

During the year, an open-end investment company registered which proposes to invest in all types of registered investment companies and in private limited partnerships, both foreign and domestic, and also to establish private limited partnerships in which it may be the only limited partner or major investor. Among other proposed investment techniques, the fund contemplates utilizing leverage, effecting short sales of mutual fund shares, making loans of portfolio stocks to mutual funds, writing put and call options on mutual fund shares held in the fund's portfolio, buying and selling put and call options written by others and making loans to private limited partnerships.

Another new fund will invest in "conglomerate" companies, i.e., those companies which assemble subsidiary companies or operating divisions in diverse industries under a central management, often through programs of acquisition, merger and tender offer, and which make extensive use of leverage in acquiring new companies.

One registrant proposed, as its main business activity, to invest in special situations by acquiring at least a controlling interest in a number of relatively small companies and supplying those companies with management and financial assistance. The securities of the portfolio companies would not be retained but sold and the proceeds used for further similar acquisitions.

Advisory Fees Tied to Performance

In recent years there has been a substantial increase in the number of investment advisory contracts providing for compensation to the investment adviser based on the performance of the investment company. At the end of fiscal 1968, some 54 investment companies with performance fees had registered; in fiscal 1969, 66 more companies with this type of fee arrangement registered. Performance fees are essentially of two types. In one type the investment adviser receives a fee (which may or may not be in addition to a basic management fee) based on a certain percentage of the investment company's net realized capital gains and net unrealized capital appreciation. The other, and more common, arrangement provides for payment of a basic fee of a percentage of the company's net assets if the company's performance is the same as that of a specified securities index or, in some cases, even if such performance is below that of the index. An additional percentage of the company's net asset value, a so-called performance bonus, is added if it out-performs the index by a certain percentage. Under such formulas, the total annual advisory fee may be as high as 6 percent of the company's net assets.

Recently, a number of investment companies have adopted arrangements which provide for decreases in compensation in the event the company tinder-performs the index. However, in many cases the percentage decrease is disproportionately less than the corresponding percentage increase. With few exceptions, both types of performance fees have been adopted by companies having capital appreciation as their objective. Frequently the companies adopting such arrangements are trading companies which engage in various speculative and high-risk investment activities. In light of these developments, the Commission proposed certain changes in the laws applicable to the receipt of performance-based fees by investment advisers of investment companies.

Study of Speculative Investment Techniques

Prompted by the increase in the number and size of registered investment companies and private investment limited partnerships ("hedge funds") engaging in speculative investment techniques such as those used by several of the funds discussed above, the Commission directed its staff to conduct a detailed evaluation of the organization and activities of such investment vehicles. The study involves an analysis of the activities of some 50 registered companies and about 200 private limited partnerships. An analysis is being made of brokerage practices; affiliations among broker-dealers, portfolio companies, and other investment companies; the composition of portfolios; and the mechanics of investment and trading operations. The staff study is designed to 'aid the Commission in determining what effects the high portfolio turnover and speculative investment practices and other activities of such companies have on the securities markets and the appropriateness of such practices for registered investment companies.

Investment Companies Which Invest in Restricted Securities

Many investment companies, both open and closed-end, have included some restricted securities in their portfolios. During the fiscal year for the first time two closed-end companies registered which had been formed for the specific purpose of investing primarily in restricted securities. Restricted securities, sometimes referred to as "letter stock," are securities acquired in private placements and other transactions exempted from registration under the Securities Act of 1933. The transferability of such securities is limited because they may not be publicly sold absent registration and purchasers generally provide letters stating that they are acquiring the securities for investment and not with a view to public distribution.

Because of the restrictions on transferability, restricted securities are different from unrestricted securities of the same class. Under the Investment Company Act, securities for which market quotations are readily available are required to be valued at such quotations. Other securities are required to be valued at fair value as determined in good faith by the board of directors. Various approaches to the valuation of restricted securities have been tried by investment companies: (1) where there is a market quotation for unrestricted securities of the same class that quotation has been used even though restricted securities were acquired at a discount from the market quotation for the unrestricted securities; (2) such discount has been maintained; (3) the discount has been amortized; or (4) a discount otherwise determined has been applied.

Valuation of an investment company's portfolio affects the price that purchasers pay for shares of the company and the amount which shareholders who redeem their shares receive. It also affects the compensation of management where such compensation is based either on performance of the company or on net asset value. Finally, since valuation affects the reported performance of the company, it has an effect upon the attitudes of investors toward the company.

For these reasons the Commission studied the valuation of restricted securities by investment companies, giving attention also to the related problems of liquidity and circumscription of investment judgment which may arise when open-end companies acquire restricted securities. Subsequent to the end of the fiscal year, the Commission issued a release setting forth its views regarding the problems inherent in the acquisition of restricted securities by investment companies.

Portfolio Turnover Disclosure

In the past, the prospectuses of new funds often expressed portfolio turnover policy in terms of reservation of freedom of action. During the fiscal year, the Commission further refined the disclosure requirements in this area. Thus, a registrant which indicated that its annual portfolio turnover rate could generally be expected to be greater than 100 percent was required to make additional related disclosures, including an explanation that such a rate means that on the average the entire portfolio would be turned over within a year and that the fund's portfolio operations would be based on short-term market considerations as distinct from long-term investment. The company was also required to disclose that such trading entailed heavier brokerage expenses and might increase Federal taxes payable. New registrants are now required to estimate their portfolio turnover rate in terms of a percentage.

FOREIGN SALES GUIDELINES

In response to the rapid expansion of many domestic registered investment companies into overseas markets and the concern that some foreign governments have exhibited about the activities of such companies in their countries, the Commission, in February 1969, published proposed guidelines on the applicability of the Federal securities laws to the offer and sale outside the United States of shares of registered open-end investment companies. The proposed guidelines call for Securities Act registration of open-end investment company shares sold abroad and for the use of a prospectus in foreign sales substantially similar to the one used domestically. In addition, the regulatory requirements of the Investment Company Act would generally be applicable. For example, the guidelines would make clear that applications under the Investment Company Act must be filed and granted to permit the foreign sale of shares at a price other than the public offering price in effect in this country. Registration requirements under the Securities Exchange Act of 1934 for foreign broker-dealers who offer and sell shares of open-end companies outside the United States were also set forth. In response to comments received, revision of certain provisions of the guidelines is currently under consideration.

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 these sections.

During the fiscal year, 249 applications were filed under these and other sections of the Act, and final action was taken as to 156 applications. As of the end of the year, 244 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:

The Slick Corporation made an offer in January 1969, to the common stockholders of Filtrol Corporation to exchange their shares of Filtrol for shares of Slick. Because of the relative sizes of the two companies Slick could acquire only about 10 percent of Filtrol's outstanding stock before exceeding the test set forth in Section 3 (a) (3) of the Investment Company Act that if 40 percent or more of a company's assets are investment securities it is an investment company. However, the term "investment securities," as defined in the Act, excludes securities issued by majority-owned subsidiaries of the owner which are not investment companies. After discussions with the staff, Slick agreed to file an application for exemption under Section 3 (b) (2), which exempts companies primarily engaged in a business other than that of investing in securities, as soon as it acquired 30 percent of Filtrol's outstanding common stock and, if at the end of the automatic exemption period of 60 days Slick had not acquired 50 percent or more of such stock and had not in that period obtained an order pursuant to Section 3 (b) (2), to dispose of sufficient Filtrol shares so that its remaining holdings of Filtrol stock would be no more than 35 percent of its assets. Within the 60-day exemption period, more than 50 percent of Filtrol's stock was acquired by Slick, and Slick's Section 3 (b) (2) application was withdrawn as moot.

Builders Resources Corporation applied pursuant to Section 6 (c) of the Investment Company Act for an exemption from all provisions of the Act. The company was organized by Property Research Corporation and Donaldson, Lufkin & Jenrette, Inc. to provide equity financing for residential construction through the formation of limited partnerships or joint ventures with small and medium sized builders. All the shares of Builders Resources were held by the two organizing corporations and six large publicly held corporations. Because the definition of "security" in Section 2 (a) (35) of the Act includes a "participation in any profit-sharing agreement," Builders Resources' participation in the joint ventures and limited partnerships could have been viewed as ownership of securities and the company might have been deemed an investment company subject to regulation. Since the six publicly held corporations each owned more than 10 percent of the voting securities of Builders Resources, the company did not come within the exception from the definition of an investment company which is provided by Section 3 (c) (1) of the Act for a company which is beneficially owned by not more than 100 persons and which is not making and does not presently propose to make a public offering of its securities. Builders Resources urged that since none of the publicly held corporations had more than-1 percent of their assets invested in the company and all the eight shareholders were financially sophisticated, regulation of the company under the Act was not necessary in the public interest.

The Commission granted the requested exemption with the conditions, to which Builders Resources consented, that (1) shareholders shall be limited to the eight present corporate shareholders and a limited number of employees who may receive options to purchase shares and (2) none of the publicly held corporations owning stock of Builders Resources shall invest more than 5 percent of their assets in Builders Resources.

The General Electric Company filed an application " on behalf of the General Electric S&S Program Mutual Fund for a number of exemptions from the Act. The Fund is an "employees' security company," and as such is subject to Section 6 (b) of the Act, which provides that the Commission shall exempt such companies "to the extent . . . consistent with the protection of investors." The Fund is a part of the General Electric Savings and Security Program under which participating employees may purchase, in addition to Fund shares, life insurance, U.S. Savings Bonds and General Electric common stock.

Several unions, whose membership includes employees of General Electric, opposed a majority of the requested exemptions. After a hearing was held and the staff in its brief to the hearing examiner opposed a number of the requested exemptions, General Electric modified its application so as to request only those exemptions which the staff considered appropriate.

The hearing examiner's initial decision granted these exemptions, with two important exceptions. General Electric had requested an exemption from Section 16 (a) to permit it to appoint the five Fund trustees, rather than have employees participating in the Fund elect them. The hearing examiner decided that General Electric could appoint only two trustees, and that the employees were to elect the other three. In addition, he denied an exemption from the requirement of Section 32 (a) that the Fund participants ratify the selection of the Fund's auditor.

At General Electric's request, the Commission reviewed the hearing examiner's decision relating to Sections 16 (a) and 32 (a). In a decision rendered subsequent to the end of the fiscal year, the Commission granted exemptions from these two Sections, concluding that the exemptions were consistent with the protection of investors in view of the special character of an employees' securities company and the safeguards provided under the terms of the Fund-and other applicable statutory provisions.

The National Association of Small Business Investment Companies, ("NASBIC") filed an application pursuant to Section 6 (c). NASBIC is a trade association whose active membership consists of 230 small business investment companies licensed by the Small Business Administration ("SBA") pursuant to the Small Business Investment Act of 1958. As of June 30, 1969, 49 of these SBIC's were also registered under the Investment Company Act as management, closed-end, non-diversified investment companies. The application, on behalf of those of NASBIC's members which are so registered, essentially seeks an order exempting them from all the provisions of the Act except those relating to registration, and transferring to the SBA the administration of those provisions of the Investment Company Act deemed applicable to SBIC's. The applicant contends that dual regulation by the SBA and this Commission has resulted in conflicts which impede the ability of small business investment companies to accomplish their statutory mission of stimulating and supplementing the flow of private equity capital and long-term loan funds to small business concerns. Hearings were held on the application, in which the SBA participated; as of the close of the fiscal year, no determination had been made.

Shortly after the close of the fiscal year, the Commission granted applications by three open-end investment companies for exemption from the retail price maintenance provision contained in Section 22 (d) of the Investment Company Act so as to permit sales of fund shares to certain groups of persons without a sales load.

Thus, Transamerica Capital Fund, Inc. was authorized to sell its shares without the usual 8y2 percent sales load to persons connected with Transamerica Corporation, the parent of both the distributor of the Fund's shares and its investment adviser, or to any one of the more than 100 subsidiaries of Transamerica Corporation, a total group of over 22,000 persons. FML Fund, Inc. was permitted to sell its shares without a sales load to persons who are officers, directors or full-time employees of the Fidelity Mutual Life Insurance Company, the parent of both the distributor of the shares of FHL Fund and of its investment adviser. And Hartwell & Campbell Fund, Inc., was permitted to continue to sell its shares without a sales charge to those persons who had been shareholders at the time that Hartwell & Campbell changed from a no-load fund to a load fund.

In N.A.S.D. v. S.E.C., the Commission's order granting First National City Bank of New York exemptions from certain provisions of the Investment Company Act with respect to a Commingled Investment Account which the Bank established and registered under the Act was affirmed by the Court of Appeals for the District of Columbia Circuit, In the same opinion, the court reversed the judgment of the district court in Investment Company Institute v. Camp, which had invalidated Regulations of the Comptroller of the Currency relied on by the Bank in establishing its Commingled Account. The NASD and the I.C.I, have each filed a petition for certiorari in the Supreme Court.

CONTROL OF IMPROPER PRACTICES

Inspection and Investigation Program

During the fiscal year, the Commission's staff conducted 72 inspections pursuant to Section 31 (b) of the Investment Company Act. Many of these inspections disclosed violations of the Investment Company Act and of other statutes administered by the Commission. Among the violations were inadequate arrangements for safekeeping of the investment company's portfolio securities, inadequate disclosures concerning the activities of the investment company, failure to maintain adequate fidelity bond coverage for persons dealing with investment company assets and self-dealing transactions which included arrangements by affiliates of investment companies to recapture fund brokerage for their own benefit.

The tremendous influx of money into the mutual fund industry and the proliferation of new funds have resulted in serious accounting and bookkeeping problems. Some funds have priced shares inaccurately because their books did not enable them to compute their net asset value correctly. As a result of back office problems, several funds voluntarily suspended sales of shares until they were able to develop new procedures for handling the increased volume of orders.

Largely as an outgrowth of information obtained during inspections, 11 private investigations were commenced during the fiscal year to develop facts concerning what appeared to be serious violations. As a result of the Commission's inspection and investigation program, approximately $1.1 million was returned to investors either directly or indirectly during fiscal 1969. This brings to $6.8 million the sums returned to investors since the inception of the inspection program in 1963.

Civil and Administrative Proceedings

During the fiscal year, the Commission instituted two civil actions and three administrative proceedings involving investment companies, and continued prosecution of other investment company proceedings.

Portfolio Transactions. -- Several proceedings involved alleged improprieties by investment advisers and principal underwriters of mutual funds in the execution of portfolio transactions for the funds and misrepresentations related to these transactions in the sales of the funds' securities.

Brokerage commissions paid by Hubshman Fund, Inc. were being recaptured by the Hubshman Management Corporation, the fund's adviser-underwriter, in return for allocations of fund portfolio transactions. The Commission accepted an offer of settlement which provided, among other things, for the repayment to the Fund by the adviser-underwriter of all amounts it had received or which had been applied to obligations of the adviser as a result of such "give-ups."

Consumer-Investor Planning Corporation, the manager-underwriter of Associated Fund Trust, and certain of the latter's affiliates, allegedly received money and other benefits in connection with investment company portfolio transactions. Two affiliated persons were directly compensated by certain broker-dealer firms in return for placing the Fund's portfolio business with those firms. In addition, compensation was received at a time when there was no valid management or underwriting contract, since the management and underwriting contracts with the Fund had been automatically terminated by the hypothecation of outstanding voting securities of the Fund's manager-underwriter. No adequate disclosure of these matters had been made in the Fund's prospectus. The Commission accepted an offer of settlement resulting in the suspension of the manager-underwriter and respondent affiliates from certain brokerage activities. In doing so it took into account that the practices had ceased and that certain payments were to be made to the Fund by the respondents.

In Provident Fund for Income, Inc. the staff alleged, among other things, that the Fund's registration statement failed to disclose that (1) the president of the Fund, who was also president of a registered broker-dealer, had made arrangements with other broker-dealers to direct commissions to his brokerage firm in return for Fund brokerage and (2) that the president's brokerage firm had received tender fees when the Fund tendered certain of its securities in tender offers. In April 1969, the Commission issued a stop order suspending the effectiveness of the Fund's registration statement; the Fund thereafter amended its registration statement, which, as amended, was declared effective.

In S.E.C. v. Salik, which involved the receipt, by affiliated persons of Republic Technology Fund, Inc., of brokerage commissions resulting from the Fund's portfolio transactions, the Commission sought an injunction against Charles E. Salik, the Fund's chairman and president, alleging, among other things, that he had accepted compensation for the purchase or sale of securities to or for the Fund, other than in the course of business as an underwriter or broker, in violation of Section 17 (e) of the Investment Company Act. On September 19, 1968, the district court entered an order, with Salik's consent, permanently enjoining him from further violating certain provisions of the Investment Company Act and the Securities Act, and the affiliates agreed to return $140,224 to the Fund, this sum representing the total amount of "give-ups" received by the affiliates on Fund transactions.

Purchase of Restricted Securities. -- Portfolio transactions by the Mates Investment Fund, Inc., involving large purchases of restricted securities, gave rise to a series of administrative proceedings. An investigation was initiated after the Mates Fund voluntarily suspended sales of its shares in June 1968 because of the chaotic condition of its books and records.

On December 20, 1968, pursuant to Section 22 (e) (3) of the Investment Company Act, the Commission, issued an order suspending the right of redemption of the Fund's outstanding redeemable securities. The Fund had applied for the order after the Commission had suspended trading in the securities of Omega Equities Corporation, a company whose securities represented almost 20 percent of the Fund's portfolio.

In June 1969, the Commission instituted an administrative proceeding against Frederic S. Mates ("Mates"), Mates Financial Services, a registered investment adviser owned by Mates, and Mates Management Company, investment adviser to the Mates Fund. Among other matters, it was alleged that, contrary to representations to Fund shareholders, Mates caused the Fund (a) to acquire substantial amounts of restricted securities, (b) to impair its shareholders' right to redemption, and (c) to obtain from banks loans of more than $7 million secured by a lien on the Fund's entire portfolio. It was further alleged that Mates improperly valued the restricted securities and misrepresented to Fund shareholders and clients and prospective clients of Mates Financial Services that the resulting increase in the Fund's net assets and net asset value per share was due to his investment advice.

On June 12, 1969, the Commission issued an Order accepting an offer of settlement. As a part of the settlement, Mates undertook that he would not become associated with a broker-dealer without the approval of the Commission, the registration of Mates Financial Services as an investment adviser was suspended for 100 days, and certain limitations were imposed on purchases of securities by the Fund. The Commission's Order stated that detailed findings and an opinion would be issued at a later date. At the same time, the Commission ordered the Fund to process requests for redemption of its outstanding shares beginning on July 22, 1969.

Transactions with Affiliated Persons. -- In S.E.C. v. Wong, involving Puerto Rico Capital Corporation, a registered investment company, the

Commission, in June 1969, agreed to a settlement with defendants Quing N. Wong and Josiah M. Scott which was thereafter approved by the U.S. District Court for the District of Puerto Rico. The Commission had asserted that Wong and Scott caused the investment company, of which they were officers and directors, to employ its assets for their use and benefit.

Under the settlement, judgments in favor of the company were entered against Wong for $350,000 and against Scott for $150,000, to be paid in designated installments; and Wong and Scott were enjoined (Wong permanently and Scott until 1977) from further violations of Section 17 (the anti-self dealing Section) of the Investment Company Act and Section 10 (b) (anti-fraud provision) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder, and from serving as officers, directors or investment advisers of registered investment companies.

In June 1969, the Commission filed a complaint in the U.S. District Court for the Northern District of Illinois seeking the appointment of a receiver for Advance Growth Capital Corporation, a registered investment company and small business investment company licensed by the Small Business Administration. The Commission's complaint also seeks an injunction against violations of the Investment Company Act by Peter D. Giachini, chairman of Advance's board of directors, and John J. Murphy, president of the company. An order is also requested, under Section 36 of the Act, barring these two persons from serving or acting as officers or directors (or in other designated capacities) of any registered investment company.

The complaint alleges that during the years since 1965 Giachini and Murphy caused companies affiliated with Giachini to sell to, and to purchase from, Advance and companies controlled by Advance, securities and other assets in violation of the prohibitions of Section 17 (a) of the Investment Company Act. The complaint also alleges that since July 1964 Giachini and Murphy caused Advance to effect numerous loan or investment transactions in which Advance and companies affiliated with Giachini were joint participants, in contravention of Section 17 (d) of the Investment Company Act and Rule 17d-1 thereunder. It is alleged that such loans and investments by Advance exceeded $2,200,000 and constituted by far the major part of Advance's business during the period in question.

Failure to Register. -- The American College Foundation, Inc. ("ACF") registered as an investment company by filing a Notification of Registration on December 26, 1967. Approximately 5 months later, on May 24, 1968, it filed suit against the Commission in the U.S. District Court for the Southern District of Florida, Miami Division, requesting the court to declare that ACF does not "fall within the purview of the Investment Company Act or the Securities Act" and to issue an order enjoining the Commission from interfering in the business of ACF. The Commission moved to dismiss ACF's suit for lack of jurisdiction over the subject matter and failure to state a claim upon which relief could be granted due to the fact that ACF had failed to exhaust its administrative remedies. On September 11, 1968, the court granted the Commission's motion.

Subsequently, the Commission brought suit against ACF and a related corporation, International University Foundation, Ltd., and certain of their associated persons. The complaint charged ACF with failure to comply with the registration and reporting requirements of the Investment Company Act. It charged that International was operating an unregistered investment company; was offering and selling unregistered securities in violation of the Securities Act; and was violating the anti-fraud provisions of that Act and the Securities Exchange Act in connection with such sales. On October 2, 1969, a judgment was entered in the case enjoining International, Gardner T. Mulloy and Robert Downs from further violations of Sections 5 (a) and 5 (c) of the Securities Act and Section 8 (d) of the Investment Company Act and ordering ACF, Mulloy and Downs to file registration statements for ACF. The charges of fraud were dismissed by consent.

Performance Fees. -- In De Renzis v. Levy, involving Oppenheimer Fund, Inc., the court found that Congress exempted investment advisory contracts with investment companies from Rule 440A. of the New York Stock Exchange, which prohibits fees for investment advisory services "based on the profits realized." It had been claimed, among other things, that the investment advisory contract between Oppenheimer Fund, Inc., and its investment adviser from 1960 to 1967 was in violation of that rule. The Commission, at the request of the court, had filed a memorandum, amicus curiae, in which it expressed the view that the contract in question violated the rule. The court disagreed with that view, holding that the rule could not be applied to a contract with an investment company. The court did not reach the question of whether a private right of action exists, as the Commission had urged in its memorandum, for violation of a New York Stock Exchange rule.

Status Cases. -- Last year's annual report discussed S.E.C. v. Fifth Avenue Coach Lines, Inc., in which certain individuals affiliated with Fifth Avenue were enjoined from violating the securities laws and a trustee-receiver was appointed to conduct the affairs of Fifth Avenue, register the company as an investment company, prosecute damage suits against certain individuals and investigate and determine whether other actions should be maintained. Appeals from that order are pending. Subsequently, the trustee-receiver, among other things, registered Fifth Avenue as an investment company and filed suit on behalf of the company against the defendants in the Commission's action and certain other individuals and corporations, alleging that certain of the defendants had systematically looted Fifth Avenue and diverted its funds to the extent of approximately $7 million. In addition, he seeks an accounting and $20 million in punitive damages.

In Tanzer v. Huffines, the Commission filed a brief, amicus curiae, urging affirmance of the district court's appointment of a receiver pendente lite for B.S.F. Company, a registered investment company, in a stockholder's derivative action. B.S.F. is one of the companies that had been under the control of several individuals who were also defendants in the Commission's action against Fifth Avenue Coach Lines, Inc. The Court of Appeals for the Third Circuit, adopting the position urged by the Commission, affirmed the receiver's appointment.

CHANGES IN RULES

Rule 22c-1 -- "Forward Pricing" of Redeemable Securities of Registered Investment Companies

Rule 22c-1, adopted October 16, 1968, prohibits any registered investment company which issues any redeemable security; or any person designated in such issuer's prospectus as authorized to consummate transactions in any such security; or any principal underwriter of, or dealer in, any such security, from selling, redeeming, or repurchasing any such securities except at a price determined in accordance with the provisions of the rule. The rule requires that the price be based on the current net asset value of such security which is next computed after receipt of a tender of such security for redemption or of an order to purchase or sell such security. Current net asset value is defined by the rule to be that computed on each day during which the New York Stock Exchange is open for trading, not less frequently than once daily as of the time of the close of trading on such Exchange. The effect of the rule is to prohibit the former practice, deemed by the Commission to result in dilution of the value of the outstanding securities of the issuer and to be unfair to security holders, of selling securities for a certain period of time at a price based on a previously established net asset value.

Rules Relating to Variable Annuities and Separate Accounts

Start-Up Exemptions. -- During the past several years, a number of insurance companies have established separate accounts for, and engaged in the sale to the public of, variable annuity contracts. Such separate accounts are investment companies within the meaning of the Investment Company Act, and many have registered as such under the Act. The securities issued by these separate accounts and the circumstances surrounding and conditions attached to their issuance have created unique problems requiring the filing of applications on behalf of such accounts for exemptions from various provisions of the Act.

As a result of experience gained in processing a number of such applications for exemptions, the Commission concluded that it would be appropriate to provide, through the promulgation of rules under the Investment Company Act, certain limited exemptions which had been previously granted by individual exemptive orders. Accordingly, on January 24, 1969, the Commission published for comment 10 proposed rules for the purpose of eliminating the need for preparing, filing, and processing applications of a routine nature in connection with the organization and operation of separate accounts.

Shortly after the close of the fiscal year, the Commission adopted new rules 14a-2,15a-3,16a-1, 32a-2, 22e-1, 27c-1, 27a-1, 27a-2, 27a-3 and 0-1 (e). Additional proposed rules relating to separate accounts are presently under consideration which, if adopted, will eliminate the need to file individual exemptive requests in other situations.

Rule 6e-1 under the Investment Company Act and Amendment of Rule 156 under the Securities Act. -- After the close of the fiscal year the Commission adopted Rule 6e-1 under the Investment Company Act and an amendment to Rule 156 under the Securities Act, which deal with another type of insurance company separate account. Rule 6e-1 exempts from the registration requirements of the Investment Company Act certain separate accounts established by life insurance companies which hold assets attributable only to pension and profit-sharing plans meeting the requirements for qualification under either Section 401 or 404 (a) (2) of the Internal Revenue Code. These are commonly referred to as "qualified plans." They include plans established for self-employed persons pursuant to the provisions of the Self-Employed Individuals Tax Retirement Act of 1962 ("Smathers-Keogh plans"), as amended, since those plans also meet the requirements of Section 401 or 404 (a) (2). The exemption is conditioned upon compliance by such accounts with all but certain designated provisions of the Investment Company Act and other requirements set forth in the rule. Unlike Rule 3c-3 under the Investment Company Act, Rule 6e-1 does not contain a prohibition, against the allocation of employee contributions to the separate account. Thus, separate accounts which meet the more restrictive conditions for exemption under Rule 3c-3 will continue to enjoy the much more extensive exemption from the Investment Company Act provided by that rule; on the other hand, a wider variety of pension and profit-sharing plans will be able to be funded through contracts participating in separate accounts which qualify for the narrower exemption under Rule 6e-l. In connection with its Rule 6e-1 the Commission also adopted Temporary Form N-6E-1 (T) and an amendment of Rule 156 under the Securities Act of 1933 to exclude transactions exempted under Rule 6e-1 as well as those exempted under Rule 3c-3 of the Investment Company Act.

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 subsidiary companies, 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 1969 fiscal year, there were 23 holding companies registered under the Act. Of these, 20 are included in the 17 "active" registered holding-company systems, 3 of the 20 being subholding utility operating companies in these systems. [Footnote: The three subholding companies are The Potomac Edison Company and Monongahela Power Company, public-utility subsidiary companies of Allegheny Power System, Inc., and Southwestern Electric Power Company, a public-utility subsidiary company of Central and South West Corporation.] The remaining-3 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 Standard Gas & Electric Company, which is in the process of dissolution.] In the 17 active systems, there are 94 electric and/or gas utility subsidiaries, 45 nonutility subsidiaries, and 15 inactive companies, or a total, including the parent holding companies and the subholding companies, of 174 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, 1969, and the aggregate assets of these systems, less valuation reserves, as of December 31, 1968.

[table omitted]

SECTION 11 MATTERS IN REGISTERED HOLDING-COMPANY SYSTEMS

To comply with Section 11 (b) (1) and the Commission's divestment order thereunder, Pennzoil United, Inc. filed a plan under Section 11 (e) providing for the transfer of its retail gas distribution properties to United Gas Inc., a newly-created Texas company. In exchange Pennzoil United will receive, in addition to bonds and debentures, the outstanding common stock of the Texas company, which Pennzoil United will offer to its own stockholders through an underwritten rights offering. The plan was approved by the Commission after the close of the fiscal year.

The plan filed by Northeast Utilities under Section 11 (e) proposing the elimination of the publicly-held minority interest in the common stock of its electric utility subsidiary company, Holyoke Water Power Company, was approved by the Commission. The plan for eliminating the publicly-held minority interest in the common stock of Michigan Gas and Electric Company, a subsidiary company of American Electric Power Company, Inc., previously reported, was enforced by a Federal District Court in Michigan by order of February 25, 1969.7

In Standard Gas and Electric Company, the Commission approved, as fair and equitable under Section 11 (e), Step VI of Standard's plan of liquidation and dissolution to comply with Section 11 (b) (2) of the Act and the Commission's orders thereunder. This Step provides for the distribution by Standard of its remaining assets, consisting of cash in the amount of about $3 million, to its common stockholders. This amount includes sums distributable to stockholders whom Standard had not been able to locate, among them stockholders with last known addresses in New York. The State of New York appeared in the enforcement proceeding in the Federal District Court in Delaware, claiming that under its Abandoned Property Law it was entitled to receive funds due to unlocated or missing New York stockholders. On January 17, 1969, the court approved and enforced Step VI to permit an initial distribution to the known stockholders of Standard but reserved for later determination the claim of the State of New York. Subsequently, the court, as urged by the Commission, denied that claim, holding that it was "fair and equitable" to distribute the unclaimed funds to the other and known stockholders of Standard. It rejected New York's argument that such distribution would represent a windfall, noting that Standard had spent funds to locate missing stockholders and had incurred even more substantial costs in its overall program of liquidation and dissolution, all of which were necessarily absorbed by its common stockholders. The court stated that liquidation of Standard Gas was required and ordered by the Commission pursuant to Section 11 (b) (2) of the Act and that to the extent that "some unclaimed funds have become available in the course of Standard's dissolution, the distribution thereof to the participating stockholders .. is realistically a reduction in the cost of dissolution to them. This is a fair and equitable application of the unclaimed funds." An appeal by the State of New York is pending.

PROCEEDINGS WITH RESPECT TO ACQUISITIONS, SALES AND OTHER MATTERS

In American Electric Power Company, Inc., reported previously, hearings were concluded on the company's application with respect to its proposal to acquire, pursuant to an invitation for tenders, shares of common stock of Columbus and Southern Ohio Electric Company, a nonassociate electric utility company, in exchange for AEP stock, on the basis of 1.3 shares of AEP common stock for each share of Columbus common stock. The Commission's Division of Corporate Regulation urged that the application should be denied, contending, among other things, that the proposed acquisition would have serious anti-competitive effects and tend towards a concentration of control of a kind and to an extent detrimental to the public interest, in contravention of Section 10 (b) (1) of the Act. The Cincinnati Gas and Electric Company and Dayton Power and Light Company each filed a brief, amicus curiae, also urging denial of AEP's application. Subsequently, AEP filed a motion, which the hearing examiner granted, to reopen the hearing to present additional evidence relating to the nature of competition in the electric utility industry. Notices of appearance in the reconvened proceedings have been filed by the U.S. Department of Justice, the State of Ohio and the Public Utilities Commission of Ohio, the Cities of Danville, Virginia, and Orrille, Ohio, and the Ohio Municipal Electric Association, Inc.

In New England Electric System, reported previously, the hearing is continuing on the proposal for an affiliation, through the creation of a new holding company, by New England Electric System and Eastern Utilities Associates, both registered holding companies, and Boston Edison Company, a nonaffiliated electric utility company. In Illinois Power Company, also reported previously, hearings were concluded on an application by Illinois Power, an exempt holding company, relating to a proposed offer to acquire, by an invitation for tenders, the outstanding common stock of Central Illinois Public Service Company in exchange for Illinois Power common stock. Illinois Power and Central Illinois are each combined electric and gas utility companies operating in Illinois. The Division of Corporate Regulation has urged that approval of the application should be conditioned on appropriate action by Illinois Power following the proposed acquisition to terminate common control of the electric utility system and the gas utility system. Certain preferred stockholders of Central Illinois appeared in opposition to the application insofar as it would permit the Central preferred stock to remain outstanding. Oral argument was held and the case was pending for decision by the Commission at the close of the fiscal year.

In Kaneb Pipe Line Company, discussed previously, the Commission, subject to certain conditions, granted an application filed pursuant to Section 2 (a) (7) of the Act by Kaneb, a products pipeline carrier, to be declared not to be a holding company notwithstanding its acquisition and ownership of 19.48 percent of the voting securities of Kansas-Nebraska Natural Gas Company, Inc., a natural gas public-utility company. The conditions, among other things, provide that Kaneb must register as a holding company before seeking stockholder approval of any merger with Kansas-Nebraska, prohibit service and other contacts between them, prohibit further acquisitions of

Kansas-Nebraska shares by Kaneb without prior approval by the Commission, and require notice of any proposed divestments of Kansas-Nebraska shares and of any intercorporate affiliations through directors, officers or otherwise, and submission of proxy material.

In Michigan Consolidated Gas Company, the Commission approved an application by Michigan Consolidated, a retail distributor of natural gas and a subsidiary of American Natural Gas Company (a registered holding company), for permission to provide financing to a newly-organized subsidiary which, pursuant to the National Housing Act, proposed to construct a low and moderate income urban housing project in the Detroit inner city.

In an opinion in which Commissioner Wheat joined, Commissioner Smith held that the proposed investment met the applicable standards of the Act, i.e., that, under Section 10 (c) (1), the acquisition would not be "detrimental to the carrying out" of the provisions of Section 11. The latter section among other things requires the Commission to limit the operations of a holding-company system to a single integrated public-utility system and such other businesses as are "reasonably incidental, or economically necessary or appropriate to the operations" of such system. Section 11 (b) (1) provides that the Commission may permit, as (i) "reasonably incidental, or economically necessary or appropriate to the operations" of the system, retention of a nonutility interest which the Commission finds is (ii) "necessary or appropriate in the public interest or for the protection of investors or consumers" and (iii) "not detrimental to the proper functioning" of the public-utility system.

Relying on cases involving the retainability of nonutility interests under Section 11 (b) (1), Commissioner Smith stated that under prior court decisions, an applicant seeking to retain or acquire such interests must affirmatively show by "exceptional facts" that the "triple test" of that Section has been met. He took the position that an operating or functional relationship between the utility system and the nonutility business proposed to be acquired was not an absolute prerequisite to the acquisition. In concluding that the necessary showing had been made, Commissioner Smith pointed out, among other things, that in this case Michigan Consolidated was making a relatively small investment meeting a critical need within its primary service district that did not involve any of the real problems with which Congress was concerned when it enacted the statute. He stated that there was

"no need to give this 1935 statute an inflexible, static historical reading. Companies subject to it are now presented with the Congressionally recognized urban problems of the 1960's and 1970's that could not have been contemplated by the original enacters. The desirability of private capital becoming involved in the rebuilding of our cities is widely recognized and urged, and the posture today of the utility industry is substantially changed, at least in terms of the weaknesses at which the Holding Company Act was directed. Equally relevant, there has been evolving since the 1930's a broader notion of corporate responsibility to the community."

In a concurring opinion, Commissioner Owens considered that the Commission should not depart from its prior interpretation that a non-utility business can be retained or acquired only if an operating or functional relationship exists between it and the utility system, but that approval of the application was warranted under the exemptive provisions of Section 9 (c) (3). Chairman Budge, dissenting, was of the view that approval of the application could not be justified on either of the grounds relied on by the other Commissioners.

In Consolidated Natural Gas Company, the Commission approved the acquisition by Consolidated of the common stock of West Ohio Gas Company, a nonassociate gas utility company, in exchange for Consolidated common stock. In Columbia Gas of Pennsylvania, Inc., the Commission approved several proposals whereby Pennsylvania, a subsidiary company of the Columbia Gas System, Inc., a registered holding company, would acquire the net assets of York County Gas Company, a nonassociate gas utility company, and assume all its liabilities. In return, York was to receive common stock of Columbia and to distribute such stock as a liquidating dividend upon its dissolution.

Middle South Utilities, Inc., a registered holding company, filed an application relating to a proposed offer to acquire, through an invitation for tenders, the outstanding shares of common stock of Arkansas-Missouri Power Company, a nonassociate electric and gas utility company, in exchange for Middle South common stock. Middle South has agreed to dispose of Arkansas-Missouri's gas properties after the acquisition. National Fuel Gas Company, a registered holding company, filed an application for permission to exchange shares of its common stock for the outstanding common stock of Producers Gas Company, a nonassociate gas utility company. Hearings were held in both cases, at which no one appeared in opposition. Following the close of the fiscal year, the Commission granted the National Fuel Gas' application.

In Municipal Electric Association of Massachusetts v. S.E.C., the Court of Appeals for the District of Columbia Circuit set aside two orders of the Commission. As previously reported, one order had authorized Vermont Yankee Nuclear Power Corporation, for the initial financing of its proposed nuclear-powered electric generating plant, to issue 100,000 shares of common stock and approved the acquisitions of Vermont Yankee stock by those 7 of its 10 sponsor companies which were subject to the Act. The second order had authorized Maine Yankee Atomic Power Company to issue 100,000 shares of common stock and approved acquisitions of such stock by those 9 of its 11 sponsor companies subject to the Act. The Commission in each case denied a request for an evidentiary hearing and for imposition of certain conditions sought by the Municipal Electric Association of Massachusetts and certain Massachusetts municipalities and their utility departments ("Municipals"), which urged that exclusion of the Municipals from participation in the Vermont Yankee and Maine Yankee projects was contrary to the Federal anti-trust policies and that the applications could not be approved unless the Municipals were afforded an opportunity to participate in these projects on the same or an equivalent basis as the sponsor companies. The court of appeals held that such exclusion was a relevant factor to be considered by the Commission in applying the standards of Section 10 (b) (1) of the Act, and accordingly remanded the two cases for reconsideration, including an evidentiary hearing if necessary.

While the petitions for review were pending, the Commission authorized Vermont Yankee to issue an additional 100,000 shares of its common stock to its sponsors and approved the acquisition by the seven sponsors subject to the Act. The Municipals petitioned for review. Upon agreement of all parties the Commission's order was set aside and the matter was remanded for reconsideration in the light of the court's previous decision. During the pendency of the review proceedings the Commission also issued two additional orders regarding the common stock financing of Vermont Yankee and Maine Yankee from which no review was sought. One order authorized Vermont Yankee to sell to its sponsors 200,000 additional shares of its common stock; and the second order authorized Maine Yankee to issue an additional 400,000 shares of its common stock to its sponsor companies. After the decision by the court of appeals these orders were amended to provide for a reservation of jurisdiction "to impose, after notice and opportunity for hearing, such conditions, if any, as may be appropriate in light of the decision" rendered by the court. The orders set aside by the court of appeals have been reinstated by the Commission and amended to include an identical reservation of jurisdiction.

Upon the remand, Vermont Yankee and Maine Yankee and their respective sponsor companies filed a proposal under which electric utility companies in the six-State New England region, including cooperatives and municipally-owned systems, would have an opportunity to purchase part of the power output of the Vermont Yankee and Maine Yankee plants. The Commission has issued an order for hearing on these proposals to determine whether the offers provide an appropriate and adequate participation in the Vermont Yankee and Maine Yankee projects and whether it is necessary that the sponsor companies amend or modify their respective proposals in light of the decision of the court of appeals.

The Commission had also authorized Vermont Yankee and Maine Yankee to issue notes to banks in the maximum aggregate amounts of $20 million and $30 million, respectively. The Municipals raised the same issues as in the stock financing cases and petitioned for review in the Court of Appeals for the District of Columbia Circuit. On November 13, 1969, the court dismissed the petitions for review without prejudice, stating that the anti-trust issues will be resolved in the stock cases.

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

During fiscal 1969, 14 active registered holding-company systems issued and sold for cash a total of 40 issues of long-term debt and capital stock, aggregating $1,019 million, pursuant to authorizations granted by the Commission under Sections 6 and 7 of the Act. Almost 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 1969. The table does not include securities issued and sold by subsidiaries to their parent holding companies, short-term notes sold to banks, portfolio sales by any of the system companies, or securities issued for stock or assets of nonaffiliated companies. Transactions of this nature also require authorization by the Commission except, as provided by Section 6 (b) of the Act, the issuance of notes having a maturity of 9 months or less where the aggregate amount does not exceed 5 percent of the principal amount and par value of the other securities of the issuer then outstanding.

[table omitted]

Competitive Bidding

All but one of the 40 issues of securities sold for cash in fiscal 1969, as shown in the preceding table, were offered for competitive bidding pursuant to the requirement of Rule 50 under the Act. The issue not sold by competitive bidding was a nonunderwritten rights offering to its stockholders by General Public Utilities Corporation, a registered holding company, of 1,275,000 shares of common stock with a total value of approximately $31,981,000.

During the period from May 7, 1941, the effective date of Rule 50, to June 30, 1969, a total of 1,053 issues of securities with an aggregate value of $16,908 million has been sold at competitive bidding under the rule. These totals compare with 239 issues of securities with an aggregate value of $2,668 million which have been sold pursuant to orders granting exceptions under paragraph (a) (5) of the Rule. Of the total amount of securities sold pursuant to such orders, 134 issues with a total value of $2,185 million were sold by the issuers, and the balance of 105 issues aggregating $483 million were portfolio sales. Of the 134 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 58 issues were in amounts ranging between $5 million and $100 million.

POLICY AS TO REFUNDABILITY OF DEBT ISSUES

The Commission's policy, which heretofore required that all long-term debt securities issued and sold by registered holding-company systems be redeemable at any time at the option of the issuer upon reasonable notice and with reasonable redemption premiums, was initially announced in 1953 and incorporated in a Statement of Policy on February 16, 1956. The Statement of Policy permitted deviations therefrom in appropriate cases, and deviations have been authorized in cases where unusual circumstances were present, including difficult problems affecting saleability of the securities. Informal requests for permission to restrict refundability have also been received from time to time, but were denied for lack of evidence that the issuer would realize sufficient savings in interest cost to justify the loss of future refunding flexibility.

The efficacy of the redemption policy as a device for implementing Sections 6 and 7 of the Act has been reviewed by the staff of the Commission at frequent intervals since its adoption in 1953, and until recently was found to have worked satisfactorily. However, in fiscal years 1968 and 1969, a number of interested persons formally requested the Commission to relax its policies concerning the redemption provisions of long-term debt securities so as to permit, if desired by the issuer, a 5-year refunding restriction. On November 20, 1968, the Commission published an invitation to interested persons to submit comments as to whether redemption provisions should be modified so as to allow some form of call protection.

On May 8, 1969, after consideration of comments received, the Commission authorized issuers subject to the Act to include in indentures with respect to new issues of long-term debt securities a provision prohibiting, for a period of not more than 5 years, the refunding of such securities by the issuance of other debt securities at lower interest costs. The Commission stated that this modification of its redemption policy would not apply to the redemption of long-term debt securities for sinking funds, or to redemptions in connection with mergers, sales of properties or for other corporate purposes, and that, when the 5-year period of nonrefundability expires, the general redemption price at which the long-term debt securities may then be called for refunding purposes shall be the same as it would have been if no restriction on refundability had been authorized. The Commission emphasized that it will continually review the effects of its redemption policies, including specifically the foregoing modification, and based on experience with this modification make such adjustments in these policies as may from time to time be deemed appropriate, including a rescission of the present modification, an extension of the 5-year nonrefunding period, or any other change which experience would warrant.

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 a plan of reorganization or to require its adoption.

The Commission has not considered it necessary or appropriate to participate in every Chapter X case. Apart 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 filed its appearance. Supervision and review of the regional offices' Chapter X work is the responsibility of the Division of Corporate Regulation of the Commission, which, through its Branch of Reorganization, also serves as a field office for the fifth area.

SUMMARY OF ACTIVITIES

In the fiscal year 1969, the Commission continued to maintain a high level of activity under Chapter X. It entered its appearance in eight new proceedings involving companies with aggregate stated assets of approximately $181 million and aggregate indebtedness of approximately $154 million. The corporations involved in these proceedings were engaged in a variety of businesses, including, among others, the manufacture of color television tubes, telemetry equipment and electrical devices; the operation of inter- and intra-state bus lines; gas and oil development; commercial, industrial and personal loan financing; and the operation of a school.

Including the new proceedings, the Commission was a party in a total of 101 reorganization proceedings during the year. The stated assets of the companies involved in these proceedings totaled approximately $913 million and their indebtedness totaled approximately $779 million. The proceedings were scattered among district courts in 32 states and the District of Columbia as follows: 11 in New York; 10 in California; 7 in Arizona; 6 in New Jersey; 5 each in Louisiana, Pennsylvania and Washington; 4 each in Florida, Illinois, Indiana and Texas; 3 each in Michigan, North Carolina and South Dakota; 2 each in Arkansas, Colorado, District of Columbia, Hawaii, Kansas, Minnesota, Nevada and Ohio; 1 each in Alabama, Connecticut, Idaho, Kentucky, Missouri, Maryland, Montana, Massachusetts, North Dakota, Utah and West Virginia.

During the year, 14 proceedings were closed. As of the end of the fiscal year the Commission was a party in 87 reorganization proceedings.

JURISDICTIONAL, PROCEDURAL AND ADMINISTRATIVE MATTERS

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

In Bankers Trust no Chapter X petitions were filed for those affiliates of the debtor whose business operations were not expected to continue. The trustee, in a petition supported by the Commission, alleged that the affiliates had been operated with funds diverted from the Chapter X debtors and, therefore, petitioned the court for turnover orders in order to obtain possession of the affiliated assets. The court granted the motion and the trustee liquidated the affiliates. The Commission assisted the trustee and the court in the evaluation of the position of the outsider, nonaffiliated, creditors. The trustee submitted final accounts, and the remaining assets of those affiliates were then made part of the Chapter X debtor estates.

In General United Corporation, Inc., the Commission, as reported previously, filed a petition for a writ of mandamus with the Court of Appeals for the Tenth Circuit seeking to require the district judge to hear on its merits the Commission's motion to classify certain shareholders of the debtor as creditors for the purpose of participating in a plan of reorganization, on the ground that they had been defrauded in violation of Section 10 (b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder. This motion had been rejected by the district judge on the ground that the Commission, although a party to the reorganization proceeding, lacked standing to bring the motion. The judge did note that the charge of fraud seemed "justified by the record." The court of appeals, in denying the petition, acknowledged that Section 208 of Chapter X "gives the Commission participation rights similar to those of other parties in a Chapter X proceeding," but it characterized the attempt of the Commission to secure classification of the defrauded stockholders as creditors as seeking, by indirection, "superior rights to other parties." The court noted that no stockholder had filed a timely claim and, since the court would not grant mandamus to a stockholder to require the district judge to consider his claim filed out of time, it would not grant this remedy to the Commission either. [Footnote: The Commission thereafter moved the court of appeals to clarify its opinion so that there would be no question that the court had made no determination binding upon the district court with respect to the fairness of the reorganization plan's treatment of defrauded stockholders or with respect to the district court's power to enlarge the time within which such stockholders might file claims. While the court of appeals denied the motion for clarification (April 9, 1969), it stated that the district court "may well comply with all the requests made in the motion so that such motion is premature" noting that the district court had "not yet had an opportunity to consider those matters."]

In TMT Trailer Ferry, Inc., as previously reported, the Supreme Court reversed the decision of the court of appeals which had affirmed an order of the district court confirming a plan of reorganization, and following remand by the court of appeals, the case was assigned to a new judge. After a hearing on a petition of the stockholders' committee to remove the trustee, the trustee resigned and a successor trustee was appointed by the district court. An extensive evidentiary hearing was held before a special master on the smaller of the two disputed claims which had been remanded for further investigation.

In Magnolia Funds, Inc., the district court appointed a receiver pending a determination whether the Chapter X petitions were filed in good faith under Section 146 (3). At the hearing, the Commission supported the petitions, urging that the possibility of a reorganization was not unreasonable in view of the receiver's operating reports and the values that might obtain by preserving the debtor as a functioning entity, including its tax loss carryover. The matter was pending for decision at the close of the fiscal year.

In Commonwealth Financial Corporation, the trustees petitioned the court to employ an attorney who was to assist the trustees in the formulation of a plan. This attorney was not disinterested as defined in Section 158 (4) of Chapter X, but the trustees contended that under the exception in Section 157 an attorney employed for "special purposes" need not be disinterested. The Commission argued that an attorney who is to render services in connection with a plan of reorganization is not within the exception provided in Section 157. After a hearing and the filing of briefs the trustees withdrew their petition.

In Biker Delaware Corp., the Commission supported, and the court approved, a petition by the trustees for permission to sell the remaining rental properties of the debtor at auction since these properties were being operated at a loss and were not necessary to a plan of reorganization. The same proceeding also involved an option held by a township to purchase all the assets of one of the debtor's subsidiaries at their actual cost. The trustees proposed to terminate the township's option by rejecting it as an executory contract. The Commission urged that the option appeared to be a contract "in the public authority" and, thus, could not be rejected pursuant to Section 116 (1). Subsequently, the township, with the approval of the district court, exercised its option by paying a fair price to the estate.

In Federal Shopping Way, Inc., as previously reported, an involuntary Chapter X petition alleged as the sole act of bankruptcy the prior appointment of a receiver in an injunctive action filed by the Commission against the debtor involving alleged fraud in the sale of securities under the Securities Act of 1933. The Commission urged that such appointment of a receiver satisfied the act of bankruptcy specified in Section 131 (2) of Chapter X. The district court judge agreed with the Commission and approved the petition. Appeals to the Court of Appeals for the Ninth Circuit from the order approving the petition have been taken by the debtor and by the Insurance Commissioner for the State of Washington, as statutory rehabilitator of Federal Old Line Insurance Company, a secured creditor, and were pending at the close of the fiscal year.

In Gladstone Mountain Mining Company, as previously reported, a voluntary Chapter X petition was filed by a dormant mining company. The petition indicated that the object of the proceeding was to increase the debtor's capital stock from 1.5 million shares to 5 million shares in order to acquire speculative assets unrelated to mining. The company has several hundred stockholders and its stock is listed on the Spokane Stock Exchange. The Commission moved to dismiss the petition for lack of "good faith" under Section 146 (3), on the grounds that, as shown by the petition, the Chapter X proceeding was instituted primarily to finance a new speculation rather than to reorganize a going concern. Prior to argument on the Commission's motion, the debtor, with the judge's approval, withdrew the Chapter X petition.

Imperial '400' National, Inc. involved the reorganization of a debtor which operates over 100 motels in many states, most of which are owned jointly through partnerships with individuals. In one such motel, located in Michigan, the debtor had a 75 percent interest and the other 25 percent was owned by a husband and wife who as partners filed a petition in bankruptcy for this partnership pursuant to Section 5b of the Bankruptcy Act. The court granted a motion by the trustee, which the Commission supported, to enjoin the bankruptcy proceeding in Michigan and pursuant to Section 32a to transfer such proceeding to the reorganization court. The court held that, having first acquired jurisdiction over the debtor and its assets wherever located, the reorganization court had jurisdiction over the partnership assets in which the debtor had a substantial interest, and that to permit the bankruptcy proceeding in Michigan to go forward might jeopardize the reorganization proceeding by separate bankruptcies of the many partnerships in which the debtor was a partner. The individual partners have appealed to the Court of Appeals for the Third Circuit.

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 Commonwealth Financial Corp., as previously reported, 19 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 was conducting a separate and independent investigation of the affairs of the debtor, including his activities, and that any information obtained by the Commission might be later used against him in a related criminal proceeding. The district court denied the motion and the Court of Appeals for the Third Circuit affirmed, noting that Section 208 of Chapter X authorizes the Commission to participate in the trustees' investigation and that the witness was free to resist examination by the Commission or by the trustees merely by asserting his privilege against self-incrimination, something he had not as yet done.

In Los Angeles Land and Investments, Ltd., as previously reported, the Commission assisted the trustee in opposing the claims filed by the three principal promoters of the debtor and supported the trustee's counterclaim for damages against the claimants. The claims of the promoters and the objections and counterclaims of the trustee were based upon and arose out of the dealings between the claimants and the debtor relating to its promotion and management at a time when the claimants were it sole officers, directors and stockholders. The referee denied the claims of the promoters to certain assets of the debtor and granted the trustee an affirmative judgment on his counterclaim in the amount of $230,000. On review the district court upheld the referee, claimants have appealed, and at the close of the fiscal year the appeal was pending.

In Continental Vending Machine Corp., as previously reported, the Supreme Court had granted certiorari on the issue of whether the depositions of certain persons could be taken in the course of a civil action against them by the trustee when those same persons had been indicted for mail fraud and violations of the Federal securities laws allegedly stemming from their relationship to the debtor. Prior to argument in the Supreme Court the trustee obtained a $2.1 million settlement from those of the defendants who had sought certiorari. Accordingly, the Supreme Court granted the parties' motion for an order vacating the judgments below and dismissing the case as moot.

REPORTS ON PLANS OF REORGANIZATION

Generally, the Commission files a formal advisory report only in a case which involves a substantial public investor interest and presents 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 the fiscal year the Commission published two formal advisory reports, and supplements thereto. Its views on four other plans were transmitted to the court by written memoranda.

In Westec Corporation, the Commission filed an advisory report and a supplement thereto on the trustee's amended plan of reorganization. The plan provided for participation by common stockholders since the company was solvent, and for participation as a separate class by those stockholders who had purchased their stock in the open market in a specified period during which, as the trustee's report disclosed, major manipulations in the Westec stock had occurred. As originally proposed, the plan provided for the issuance of stock options to key employees and officers, the terms and conditions of which could be determined by the board of directors without stockholder approval unless the stock to be issued under the options should exceed 7 percent of the outstanding stock. The Commission took the position that the issuance of stock options pursuant to a plan of reorganization is not in accord with the policy of Chapter X, but further stated: "Once the reorganization is completed, and a measure of financial success is achieved, management, having shown its value, can submit under local law an appropriate resolution authorizing stock options." The plan was amended to conform with the views of the Commission. Suspension of trading in the Westec stock was terminated and trading on the American Stock Exchange was resumed on May 5, 1969.

In Parkwood, Inc. the trustee's plan of reorganization for the debtor and its subsidiaries, all real estate companies, provided for Parkwood to receive all of those properties in which there is an equity above the first and second mortgages, and for Adams Properties, Inc., a subsidiary of Parkwood, which is to be a separate corporation, to receive all those properties having an equity above the first mortgage but not above the second mortgage. The Commission, in its advisory reports, concluded that the plans of reorganization were fair and equitable and feasible, but recommended three amendments, which the trustee adopted. Under the plan, one group of creditors, the holders of the second mortgage notes on properties which were turned over to reorganized Adams, are to release their security interest and receive in exchange shares of preferred stock in Adams. Since each series of stock was to represent an equity in the specific property which had secured the second mortgage notes, the Commission characterized each series of "stock" as essentially a liquidating interest in a particular property junior to a first mortgage. The Commission suggested that this be reflected by issuing nonnegotiable liquidating certificates corresponding to the proposed preferred stock. Second, instead of certificates of participation in any proceeds recovered in lawsuits filed by the trustee, the Commission recommended, as one alternative, that no certificates be issued and that distributions of proceeds be made to trade creditors whose names are to be recorded on a list of participants filed with the court. The Commission also recommended that the real properties of the reorganized companies be recorded on the balance sheets at their historical cost, rather than at the higher valuations of the trustee, Although such a valuation would result in Adams emerging from reorganization with a deficit in its common stock account, the Commission stated that this was unobjectionable since reorganized Adams was to be essentially a liquidating company. The plan as amended was approved by the district court on August 7, 1969 and was confirmed on November 17, 1969.

In Bankers Trust, the Commission recommended approval of the trustee's plan of reorganization which provided, among other things, for the consolidation of five debtors into one reorganized company. Since the debtors appeared to be solvent the plan provided for the issuance of new shares of the reorganized company to certificate holders of the five debtor trusts on the basis of the original investment of the certificate holders, with no separate valuation of the equity in each of the debtor trusts since the five trusts have been operated as a single enterprise. Since the reorganized company will be subject to the reporting requirements of the Securities Exchange Act of 1934 and the rules promulgated thereunder, the Commission recommended that as soon as practicable after confirmation the pro forma financial statements should be submitted to the Commission for examination and review in the light of these statutory requirements. The court approved a plan in accordance, with the Commission's recommendations.

In Maryvale Community Hospital, Inc., the trustees sold the physical facilities of the debtor, a nonprofit community hospital, to the Good Samaritan Hospital, a nonprofit corporation, for cash plus the assumption of certain contingent liabilities. Subsequently, the trustees proposed a plan to liquidate and to dissolve the debtor after retiring the outstanding bonds, which were publicly held, with the proceeds of the sale. The plan proposed payment to the bondholders of the principal amount of the bonds, simple interest as specified in the indenture, interest on interest, and a redemption premium. Payment of interest on interest and the premium were opposed by the State of Arizona and certain nonprofit corporations which were beneficiaries under the provision of the debtor's corporate charter that upon dissolution the assets of the debtor remaining after discharge of its valid obligations should be turned over to certain classes of public and private charities. The Commission supported the payment of interest on interest as to which, the Commission stated, the bondholders had a superior claim in equity against those who were no more than legatees under the corporate charter. However, the Commission opposed the payment of the premium because prepayment of the bonds was not a voluntary act but forced upon the debtor under the requirements of Chapter X. In its decision of November 3, 1969, the court held that the bondholders were entitled both to interest on interest and the redemption premium.

In Realsite, Inc., after 6 years of administration in Chapter X, during which time the debtor was substantially liquidated, the trustee filed a plan based on a proposal by a nonaffiliated company to transfer to the reorganized debtor unimproved property plus some cash. The plan provided that for this property and cash the plan proponent would receive 820,000 shares of new common stock and 20,000 shares of $5 par value convertible preferred stock, and the reorganized company would assume a mortgage indebtedness of $175,000. The presently outstanding common stock, publicly held, would be exchanged for 400,000 shares of new common stock. The Commission opposed the plan, for lack of feasibility since the debtor was substantially liquidated and liquidation was to continue by the sale of lots in the real property to be contributed by the plan proponent. The Commission also indicated that the principal attraction of the debtor seemed to be the possibility of utilizing its tax loss carryover and possible values generated by public trading and sharp fluctuations in prices that often are characteristic of stock with nominal and speculative earnings. The court denied approval of the plan, and by a subsequent order denied a petition for reconsideration and rehearing on an amended plan under which the proponent offered to contribute another parcel of undeveloped land to the reorganized company. Two stockholders of the debtor as well as the plan proponent have appealed from both orders to the Court of Appeals for the Fifth Circuit and the appeals were pending at the close of the fiscal year.

In Canandaigita Enterprises Corp., the court approved and confirmed, as recommended by the Commission, a plan providing for the cancellation of all issued capital stock and the issuance of newly authorized capital stock to be auctioned at the direction of the court. The new stock was to be offered for sale at auction with bids to be made as a percentage of the claims of general unsecured creditors in an amount not less than 80 percent of such claims as allowed. The plan proponent agreed to submit a bid to pay general unsecured creditors, other than debentureholders, 80 percent of their claims as allowed in cash and to pay debenture-holders 80 percent of the principal amount of their debentures. Stockholders of the debtor were eliminated from participation.

As previously reported, the court approval of an earlier plan of the trustee was appealed by an unsuccessful plan proponent. Although that plan had been effectively superseded by the auction plan discussed above, the appeal from the earlier plan was prosecuted, and in affirming the district court the court of appeals affirmed the finding of insolvency. Thereafter the auction plan was accepted by the requisite number of creditors and confirmed.

ACTIVITIES WITH REGARD TO ALLOWANCES

Every reorganization case ultimately presents the difficult problem of determining the compensation to be paid to the various parties for services rendered and for expenses incurred in the proceeding. The Commission, which under Section 242 of the Bankruptcy Act may not receive any allowance for the 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 187 applications for compensation totaling about $4.3 million were received.

In Arlington Discount Co., as reported previously, the Commission's motion under Section 328 of Chapter XI 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 had recommended an allowance of $15,000. The district court allowed $7,500, finding that such an amount had been agreed to by the parties and stating, among other things, that the use of Chapter XI by the attorneys had been "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). On appeal, the Court of Appeals for the Sixth Circuit stated that the finding of the district court of an agreement limiting the allowance to $7,500 was not supported by substantial evidence. It further held that its review of the services rendered revealed that not all of them were properly compensable as beneficial to the estate, and it directed an allowance of $17,500. The court did not discuss the issue whether the district judge, in determining the fee to be awarded, could properly take into account the fact that the proceeding apparently should originally have been brought under Chapter X.

In TMT Trailer Ferry, Inc., attorneys for the Independent Stockholders' Protective Committee applied for an interim allowance. While recommending an amount less than that sought, the Commission supported the application because the committee had rendered services for over 10 years and the major services related to the successful opposition to the confirmed plan of reorganization. A hearing was held and the district court found that the attorneys were entitled to an interim allowance but reserved the determination of the amount. Thereafter the court, on an ex parte motion by the successor trustee, vacated its order. The attorneys for the committee renewed their application, which the Commission supported, and at the close of the fiscal year it was still pending.

In Manufacturers' Credit Corporation, as previously reported, the court granted the Commission's motion under Section 328, and subsequently approved Chapter X petitions for the parent and 18 subsidiaries. The Chapter XI receiver and his two attorneys sought interim allowances totaling $150,000 from the Chapters X and XI estates for services rendered while the debtors were in Chapter XI. The referee granted interim awards of $40,000 to the receiver and $35,000 to each of his attorneys, allocating 70 percent to the Chapter X companies and 30 percent to the Chapter XI companies on the basis of the relative income of the debtors involved rather than upon services rendered. The Commission opposed the award of interim allowances, urging that in Chapter X interim allowances are appropriate for officers of the court who are expected to render services to the estate over a period of time, and hence not to the Chapter XI receiver and his attorneys whose services have been completed. It urged further that no allowances should be awarded until the end of the proceeding since the estates were in precarious financial condition. At the close of the fiscal year the matter was still pending.

In Hydrocarbon Chemicals, Inc., as previously reported, the district court denied compensation to the two attorneys retained by the debtor's principal attorney, who had sought compensation for services rendered during the Chapter XI proceeding which preceded the Chapter X proceeding, 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). On appeal, the Court of Appeals for the Third Circuit held that General Order 44 did not bar the award of compensation. Since a receiver had been appointed during the Chapter XI proceeding, the debtor had not been in possession and General Order 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 the Chapter

XI proceeding. The court of appeals remanded to the district court for-its consideration the questions of whether the service could have been performed only by counsel for the Chapter XI receiver and the amount of compensation, if any, to be awarded. Upon rehearing en bane, five of the eight participating judges voted to affirm the district court. While there was no opinion in which a majority of the court concurred, an opinion joined in by three of the five judges who voted for affirmance sets forth various grounds for concluding as a matter of law that the attorneys were not entitled to compensation. The Supreme Court denied certiorari.

In Polycast Corporation, the trustee sought final compensation of $69,000, the Commission recommended about $36,000, and the district court awarded $41,000. In a memorandum opinion, the court agreed with the Commission that $69,000 was far more than the estate could afford, taking into consideration, among other factors, its size and the cash available. It also agreed with the Commission that the rate at which the trustee would have billed a client for professional consulting service does not control the measure of his compensation under Chapter X. The court, further agreeing with the Commission, denied the trustee's request for "portal-to-portal" compensation for the time consumed in almost daily 26-mile round trips from his home to the debtor's place of business and reimbursement for the cost of those trips. The Commission had expressed the view that the time and money spent for this purpose were part of the trustee's overhead and not chargeable as an expense against the estate. The court also agreed with the Commission that the trustee was not entitled to a fee for the time that he had devoted to preparing his application for compensation.

In Biker Delaware Corporation, the court, as urged by the Commission, denied all reimbursement for expenses because the trustees, their counsel, and their accountants had not kept itemized records of disbursements. In the initial hearing before the referee as special master on interim allowances, the Commission urged that adequate notice was not given as required by Section 247 because the notice did not state the name of the applicants, the capacity in which the applicants were claiming compensation, and the amounts requested. The referee denied the Commission's request to adjourn the hearing, but prior to the hearing before the district court on the special master's report, proper notice was sent to creditors and stockholders.

In Webb & Knapp, Inc., the counsel for the trustee, who had been granted $120,000 as an interim allowance in the prior year, applied for an interim allowance of $150,000 for services rendered in the current year. The Commission recommended $75,000 because, among other things, the total time spent by counsel was about 30 percent less than in the prior year, the time spent by partners decreased from 19 percent to approximately 16 percent, and counsel had supporting records for only 90 percent of the total time for which compensation was sought. The court awarded $90,000.

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 Time Sales Finance Corporation, the debtor proposed an arrangement providing for full payment in cash to all unsecured creditors, except the debentureholders who were to receive 40 percent of the principal amount of their claims in a preferred stock of an unrelated corporation. The Commission moved pursuant to Section 328, urging that the proposed plan involved more than a minor adjustment of unsecured debt and that past financial activities of the debtor warranted a disinterested investigation by a Chapter X trustee. The referee refused confirmation of the plan of arrangement and adjudicated the debtor a bankrupt, and the Commission's motion became moot.

In Peoples Loan & Investment Company, the debtor, an industrial loan institution, had issued over $7 million in debt securities to more than 3,000 public investors. The proposed arrangement under Chapter XI provided that each investor could elect to receive 55 percent of his claim in full settlement immediately or larger percentages within a 5-year period. Under any alternative, however, the total payment would be substantially less than the principal and interest of the claim for which each public creditor had contracted with the debtor. The arrangement also effected a compromise settlement of a large claim of the debtor against an insurance company; as a result of the settlement, control of the debtor would pass to the insurance company. The denial of the Commission's Section 328 motion by the district court was reversed by the Court of Appeals for the Eighth Circuit, which held that the extensive evidence of mismanagement and self-dealing together with the considerable reduction in the claims of the public creditors while the interests of the equity holders of the debtor were not affected required ". . . the extensive protection provided by Chapter X . . .; namely a disinterested trustee, a plan of arrangement formulated by the trustee (rather than the debtor) with the S.E.C.'s analysis of the plan and its informative report to the public creditors, an investigation of past management practices and prosecution of any legitimate claims, and the fair and equitable requirement of strict priority of creditors' claims over equity interests."

In Norman Finance and Thrift Corporation, the debtor, a company engaged in the consumer finance business through its wholly owned subsidiaries, had sold to the public unsecured debt obligation: which it called "thrift savings accounts." A substantial amount of the funds obtained from the public had been used for the personal investment purposes of the debtor's president and controlling stockholder Subsequently, the insurance company which had insured these ac counts and which was now in control of the debtor cancelled its policy with the debtor, claiming it had been fraudulently induced (by the former president of the debtor) to insure the accounts. The debtor proposed a plan of arrangement under Chapter XI offering the 60 public investors, whose claims totaled over $1,250,000, an election between two alternatives: (1) payment of each claim in the proportion of 40 percent in new debentures and 60 percent in new common stock to be issued by the debtor or (2) 70 percent in debentures. Acceptance of the arrangement was to be in complete settlement of all claims the public investors had against the insurance company, as well as against the debtor. After the close of the fiscal year the Court of Appeals for the Tenth Circuit reversed the order of the district court which had denied the motion of the Commission made under Section 321 The court of appeals stated that although courts are usually reluctant to interfere in situations where, as here, some sort of consent has bee obtained, especially by those "whose money is at stake," it appeared that here the consents had been solicited on a "take or leave basis and with the suggestion that the alternative to acceptance would be litigation and liquidation in bankruptcy. The court said that either of the options presented to the investors represented a "drastic adjustment of their rights." The court also noted that under Chapter XI creditors were entitled to full payment of their claims before stockholders could participate and, under the arrangement, it was possible for either the new or old management to retain control of the corporation. The court further stated: "In view of the apparent prior mismanagement of the debtor and possible claims against prior office, it is apparent that some independent investigation of the corporation's financial affairs is required. This disinterested evaluation can only accomplished under Chapter X." The cancellation of the insurance coverage also required the need for such an independent investigation and disinterested evaluation.

In both the Peoples and Norman Finance decisions, the courts of appeals indicated, as the Commission had urged in each case, that the decision of the Supreme Court in Securities and Exchange Commission v. American Trailer Rentals Co., required that the attempted rehabilitations take place under Chapter X. The Supreme Court there stated that ". . . as a general rule Chapter X is the appropriate proceeding for adjustment of publicly held debt," and indicated ". . . the narrow limits within which there are exceptions to this general rule . . .," as extending to situations where the public investors are few in number and familiar with the operations of the debtor, or where, although the public investors are greater in number, the adjustment of their debt is relatively minor, consisting, for example, of a short extension of time for payment."

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. As indicated below, it is also available for public inspection both at the offices of the Commission and the exchanges upon which particular securities may be listed.

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 4,366 registration statements filed with the Commission (not including investment company offering proposals filed as amendments to previously filed statements), 998 notices of filings, orders, decisions, rules and rule proposals issued by the Commission, 304 developments in litigation under its enforcement program, 8 releases on corporate reorganization proceedings, and 80 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 4,330 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.

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 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 record 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, 1969. The rule also establishes a procedure to be followed in required 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. The copies are produced by a commercial copying company which supplies them to the public at prices established under a contract with the Commission. Current prices begin at 9 cents per page for pages not exceeding 8 1/2" x 14" in size, with a $2 minimum charge. Under the same contract, the company also makes microfilm and microfiche copies of Commission public documents available on a subscription or individual order basis to persons or firms who have or can obtain viewing facilities. In microfiche services, up to 60 images of document pages are contained on 4" x 6" pieces of film, referred to as "fiche." Annual microfiche subscriptions are offered in a variety of packages covering all public reports filed on Forms 10-K, 9-K, 8-K, N-1Q and N-1R under the Securities Exchange Act of 1934 or the Investment Company Act of 1940; annual reports to stockholders; proxy statements; new issue registration statements; and final prospectuses for new issues. The packages offered include various categories of these reports, including those of companies whose securities are listed on the New York Stock Exchange, the American Stock Exchange, or regional stock exchanges, or traded over-the-counter, and standard industry classifications (S.I.C.). Arrangements also may be made to subscribe to reports of companies of one's own selection. The subscription services system may be extended to further groups of filings in the future if demand warrants. The company also will supply, at reasonable prices, copies in microfiche or microfilm form of other public records of the Commission desired by a member of the public. Microfiche readers and reader-printers will be installed in major public reference areas in the Commission's headquarters and principal regional offices, and sets of the microfiche will be available for inspection there.

Visitors to the public reference rooms of the Commission's Washington, D.C., New York and Chicago offices also may make immediate reproductions of material in those offices on coin-operated copying machines at a cost of 25 cents per 81/2" 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 1969 fiscal year, 12,345 persons examined material on file in Washington and several thousand others examined files in the New York, Chicago, and other regional offices. More than 25,367 searches were made for information requested by individuals and approximately 3,400 letters were written with respect to information requested.

ELECTRONIC DATA PROCESSING

Extension of Application of Automation Techniques

During the 1969 fiscal year the Commission continued the implementation and improvement of existing and planned uses of EDP which were described in previous annual reports.

In further expanding the use of automation for analysis of data related to the financial structure of business and the economics and practices of the securities industry, two new EDP systems were developed and are currently being implemented. One of the systems is designed for compilation and the analysis of working capital and long-term debt data contained, in quarterly reports of nonmanufacturing companies registered with the Commission. The other system has been designed for the analysis of statements submitted in connection with the study of "hedge funds" discussed above at page 18.

EDP applications planned for the future include a system for compiling and analyzing plant and equipment expenditure data reported quarterly by companies registered with the Commission.

Increase in EDP Capability

During the past year the Commission increased its EDP capability by making certain modifications and additions to existing computer programs and hardware.

A program package supplied by the company from which the Commission had acquired its EDP equipment was adapted to existing Commission programs in order to increase the speed of processing data through the EDP systems. Two Model 2311 disk units were leased and the Model 40 control processing unit was modified to double its capacity. These changes have resulted in more efficient use of the Commission's EDP facilities and an opportunity to take advantage of more advanced programming techniques. Among the advantages is the capability to process two jobs through the computer simultaneously.

Assistance to State and Federal Agencies

Through procedures developed in fiscal 1968-9 to promote the coordination of regulatory activities, the Commission, during the past year, continued to supply certain information from its computer files to State authorities and self-regulatory institutions. In addition, it continued to furnish selected data from those files to several Federal agencies. Among other things, over-the-counter market data was made available to the Federal Reserve Board for use in its administration of Regulation 17 under the Securities Exchange Act of 1934 (relating to the extension of credit by banks).

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 increased the computer time provided from about 2,000 hours to about 3,000 hours per year. This was done at a significant savings to the Government as compared with the prevailing rates of outside sources. The Commission also continued its supplemental agreement with the Center for key-punch and key-verification services. During the past fiscal year approximately 1,400,000 cards were punched and verified for the Department of the Navy.

EDP Training

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

These procedures were described in the 34th Annual Report,.

PERSONNEL AND FINANCIAL MANAGEMENT

Personnel Program

In fiscal 1969, the Commission continued its efforts to recruit outstanding college and law school students with the specialized academic training required for its fields of work. A special recruitment brochure, entitled "Are You Unique?" was prepared jointly with 16 other small agencies for distribution to all colleges and law schools in the fall of 1969 through the facilities of the Interagency Board network of the Civil Service Commission.

While the Commission is able to recruit highly qualified law school graduates, the retention of attorneys who have progressed to middle and higher grade levels continues to be a major problem. After 3 or 4 years of service with the Commission, many of these lawyers resign from the staff to accept attractive offers in private law practice or industry at salary levels considerably in excess of the amount the Commission is able to pay under the Federal salary scale. Exit interviews confirm the fact that the main reason for the departure of these attorneys is one of economics.

Public recognition is an essential factor in building and maintaining the prestige of Federal careers, and awards granted by outside organizations improve the quality of public administration and the morale and career service motivations of Federal employees. In fiscal 1969 David Ferber, Solicitor of the Commission, and Irving M. Pollack, Director, Division of Trading and Markets, were joint recipients of a Rockefeller Public Service Award. This award of $10,000 is presented annually to five Federal career employees whose careers in five broad fields of Government have brought singular honor to the Federal service. Messrs. Ferber and Pollack are the fifth and sixth members of the Commission's staff to receive Rockefeller Awards since the awards were established in 1951. Arthur F. Mathews, former Deputy Associate Director of the Division of Trading and Markets, received one of six 1969 Younger Federal Lawyer Awards from the Federal Bar Association for his outstanding contributions to criminal law enforcement in the securities area.

Personnel officials of the Commission actively participated in workshop committees sponsored by the Interagency Advisory Group of the Civil Service Commission. Three such committees were the Committee on Joint College Recruiting for Smaller Agencies, the Committee Federal Merit Promotion Policy and the Committee on Evaluation Personnel Programs.

In its report on employee training in the Federal service for the fiscal year 1968, the Civil Service Commission commented favorably on the Division of Trading and Markets' practice (continued during fiscal year 1969) of sending teams of analysts and/or attorneys to New York City for 3 days each for first-hand exposure to the problems of the New York Stock Exchange and its member firms, as a good example of updating "state of the art" training. Significant training programs conducted by the Commission during fiscal 1969 included (1) a course in Basic English for stenographers, typists and clerks offered free of charge after hours, (2) participation in the "From Nine to Five" television secretarial course presented jointly by the Civil Service Commission and a local educational TV station and (3) various in-house training courses offered by the Divisions of Trading and Markets, Corporation Finance and Corporate Regulation.

As a part of the Commission's Fourteenth Annual Service and Merit Awards Ceremony held in October 1968, Distinguished Service medals were awarded by the Commission to David Ferber, Solicitor of the Commission; James E. Newton, Regional Administrator of the Seattle Regional Office; Harry Pollack, Director of Personnel; Eugene H. Rotberg, former Associate Director of the Division of Trading and Markets; and Charles E. Shreve, Director of the Division of Corporation Finance. The Supervisory Excellence Award was presented to James C. Foster, Special Assistant to the Director of the Division of Trading and Markets, in recognition of his excellence in fulfilling both his "people" and "program" responsibilities.

Twenty employees were given 30-year pins for SEC service; within-grade salary increases in recognition of high quality performance were granted to 71 employees; and cash awards totaling $15,723 were presented to 116 employees for superior performance or special service.

Personnel Strength; Financial Management

The following comparative table shows the personnel strength of the Commission as of June 30, 1968 and 1969.

[table omitted]

On June 30, 1968, the Commission's accounting system was approved by the Comptroller General of the United States.

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 national securities association (the National Association of Securities Dealers (NASD) is the only such organization); and (5) certification of documents filed with the Commission.