45th Annual Report
of the
Securities and Exchange Commission

for the fiscal year ended
September 30, 1979

Chairman's Letter of Transmittal

The Honorable Walter F. Mondale
President, U.S. Senate
Washington, D.C. 20510

The Honorable Thomas P. O'Neill, Jr.
Speaker, U.S. House of Representatives
Washington, D.C. 20515

Gentlemen:

I am pleased to transmit the Annual Report of the United States Securities and Exchange Commission for the fiscal year ended September 30, 1979. As I have in connection with the Commission's last two Annual Reports, I would like to summarize in this letter some of the significant challenges which the Commission has faced, and achievements which it has realized, during the past year. I want also to describe several of the areas to which the Commission will be devoting its efforts in the coming year.

After 45 years of successful administration of the Federal securities laws – a period during which the Commission earned recognition as a highly effective Federal regulatory agency – it is taking a close look at whether its rules, procedures, and internal operations remain adequate and appropriate to the capital markets of the 1980s. This examination comes at a time when the Commission is already facing the challenge of stretching limited resource levels to meet its steadily increasing responsibilities.

Since 1975, during a period in which the Commission actually *lost* a significant number of staff positions, the Commission has experienced an explosion in the number and complexity of its regulatory responsibilities – in large part, for two specific reasons. First, significant changes have occurred in the financial markets and community – including greatly expanded market activity, increasing complexity of financial transactions, the development of a new mix of

financial products being offered to the public, and the increasingly high financial leverage of the broker-dealer industry. As illustrations, during the period from 1975, the number of shares annually traded in the NASDAQ system increased over 150 percent, the number of contracts for exchange-traded options increased over 250 percent, the number of registered investment advisers increased by approximately one-half, there were approximately $100 billion worth of *successful* tender offers, and in the last year alone the assets of money market funds increased almost five-fold. Such remarkable growth is expected to continue – in January 1980, the volume of trading in New York Stock Exchange-listed securities on the composite tape, American Stock Exchange-listed and over-the-counter traded securities totaled 2.165 billion shares. Just a year earlier, the January figure was less than one-half that amount; two years earlier, it was only about one-third of this year's figure.

Second, during this same five-year period, Congress charged the Commission with a wide range of new regulatory responsibilities and legal obligations. Some of these mandates to which it must allocate significant resources, such as the Freedom of Information Act, are not unique to the Commission. But other requirements are. For example, in 1975 Congress directed the Commission to facilitate the establishment of a national market system for securities. Further, the Commission has been charged with implementing the Foreign Corrupt Practices Act and has undertaken a greater role to achieve more effective oversight and self-regulation of the accounting profession. The Commission also has devoted considerable resources to reviewing the American Law Institute's proposed Federal Securities Code, which, it is anticipated, will be introduced in the Congress. Moreover, recent judicial developments, which have severely hampered private rights of action, mean that in many cases, no party other than the Commission can seek judicial enforcement of the federal securities laws.

Major changes in the Commission's operations have been necessary to cope with this increased workload in the face of diminished staff allocation. In order to maintain the Commission's traditionally high level of investor protection, it has had to increase efficiency,

reallocate personnel, reorganize structure, develop new management strategies, and rely on unpaid overtime donated by its highly-motivated staff. This drive for even more efficient utilization and allocation of our resources will, of necessity, continue in the coming year. Nonetheless, such efforts can accomplish only so much. The Commission is concerned that continually growing demands on limited resources impair its existing programs and functions. In a number of areas, underallocation of staff, because of needs to immediately meet other demands, already has resulted in performance capabilities diminishing to a level which the Commission does not consider adequate. For example, the Commission's inspections of many of the financial entities which it regulates are too infrequent to be optimally effective in protecting the public.

The Securities Markets

The Commission continued its efforts, during fiscal 1979, to implement its Congressional mandate to facilitate the establishment of a national market system for securities. As part of its efforts to identify the objectives and framework of such a system, during fiscal 1979, the Commission proposed three significant rules: Rule 11Ac1-3 to provide price protection for public limit orders; Rule 19c-3 to limit extension of off-board trading restrictions; and Rule 11Aa2-1 to define criteria for securities to "qualify" for trading in a national market system. The securities industry, meanwhile, strengthened the two principal experiments in technology which may become, or help determine, a foundation of a national market system – the Intermarket Trading System and the Cincinnati multiple-dealer trading facility. Both of these projects also received authority from the Commission to continue operating until January 31, 1983. Two additional private sector initiatives in this area were the commitment by the participating exchanges in the Intermarket Trading System to a joint limit order protection plan, and the agreement by the New York and American Stock Exchanges to make generally available their common message switch.

Trading in exchange-listed options also received a great deal of attention from the Commission during the fiscal year. In December

1978, the Special Study of the Options Markets submitted to the Commission the 1,000-page report of its comprehensive 14-month study. The Commission released the staff's report publicly in February 1979, and announced the conditions under which it would permit an expansion in options trading. During the balance of the fiscal year and into fiscal 1980, the staff worked closely with the securities industry's self-regulators toward implementing many of the recommendations of the Study. Although the task was complex and difficult, the cooperation between the Commission's staff and the industry's representatives has been excellent. I anticipate that in the coming fiscal year the Commission will authorize an expansion of "trading in this segment of the securities market.

The Full Disclosure System

The Commission's statutory mandate to require corporations to disclose all material information to the investing public is at the heart of the capital formation process. In accordance with the 1977 recommendations of its Advisory Committee on Corporate Disclosure, the Commission is pursuing an on-going program designed to enhance the effectiveness of its disclosure requirements, while reducing attendant burdens to the extent practicable. During the fiscal year, the Commission took a number of important steps towards this goal.

As part of this program, the Commission has begun a thorough review of filings under the separate disclosure systems prescribed by its two most fundamental disclosure statutes – the Securities Act of 1933 and the Securities Exchange Act of 1934 – to reduce reporting burdens and paperwork by more precisely tailoring the reporting requirements to the characteristics of particular registrants and to the needs of their investors. This program also has been substantially advanced by the Commission's efforts, which culminated in proposals, published subsequent to the close of the fiscal year, to amend Form 10-K to serve as the cornerstone of a new "integrated" disclosure system and to centralize the instructions for financial statements in various reporting forms. In addition, during the last fiscal year, the Commission continued its efforts to encourage issuers

to provide investors with forward-looking and other forms of "soft" information, such as performance projections.

Other actions by the Commission during fiscal 1979 designed to make the full disclosure system more effective include the adoption of significant rules governing public tender offers and "going private" transactions. In addition, important progress was made in the Commission's comprehensive examination of shareholder participation in the process of corporate accountability. That study, which began in 1977, has resulted in significant amendments to the Commission's proxy rules in both fiscal 1978 and 1979. The study's final report is expected during 1980.

One of the Commission's major initiatives during fiscal 1979 has been its efforts to facilitate capital formation by small businesses without materially diminishing the protections afforded public investors. The Office of Small Business Policy, established in June 1979, serves as liaison with the small business community and generates proposals to eliminate unnecessary impediments to the ability of small businesses to raise capital in the securities markets. As a result of that Office's recommendations, the Commission has liberalized the rule regarding resale of restricted securities, adopted a new "short form" registration statement for certain smaller issues of securities, and created a new exemption from registration for other types of relatively small issues of securities. In coordination with the Department of Commerce, the Commission also developed a monitoring program to assess the impact of our regulations on small businesses, and in conjunction with the Small Business Administration, is studying the role which regional broker-dealers play in the capital formation process.

In order to make the Commission's review of corporate disclosure documents more meaningful, the staff unit with primary responsibility in this area, the Division of Corporation Finance, has been reorganized with its operational branches restructured according to industry groups. The Division's new operational plan recognizes that the staff cannot adequately review every document filed, and relies, instead, on an "audit mode" and quality control techniques to enable

the staff to give prompt and thorough scrutiny to key filings while devoting less resources to reviewing more routine documents.

Investment Companies and Advisers

Staff task forces are conducting a comprehensive review of the Commission's regulation of investment companies and investment advisers. With regard to investment companies, the Commission has adopted a number of rules to lessen the costs and burdens associated with their regulation – which historically has been based, to a large extent, on the Commission's prior-clearance of transactions – by enhancing the role of directors in managing investment companies. The goal of diminishing the Commission's presence in routine investment company business decisions also is reflected in the Commission's withdrawal, in March, of its "Statement of Policy" on investment company advertising and in its adoption, in August, of Rule 434d to permit investment companies much more flexibility in mass media advertising. The effect of these actions place responsibility for fair presentation of investment company advertising material on boards of directors rather than on arbitrary rules and staff clearances. The Commission also has requested public comment on a proposal to relax the prohibition against an investment company's using its assets to merchandise the sale of its shares. These efforts by the Commission to de-emphasize governmental prior-clearance of investment companies' business practices, while resulting in substantial private sector benefits, will place even greater emphasis on its increasingly stretched inspection capabilities to determine that such practices comply with the Federal securities laws.

As to investment advisers, the Commission has identified anomalies in the pattern of investor protection which it is striving to resolve with the least possible burden to that industry. For example, in response to a long-standing concern as to the adequacy of information provided to clients of investment advisers, the Commission adopted a new rule to require that certain investment advisers disclose to clients and prospective clients their background and business practices.

Ensuring Informed Regulation

The Commission recognizes that no regulatory agency can successfully fulfill its legislative mandate unless it understands the industry it regulates and the economic consequences of its actions. Accordingly, the Commission is placing increasing emphasis on gathering and analyzing empirically-based information.

As part of its efforts to better assess the consequence of its regulations, the Commission has strengthened its capability for economic analysis. The revised format of the Commission's annual report on the securities industry and the recent report on the impact of the Commission's implementation of the Congressionally-mandated separation of money-management and floor brokerage illustrate this capability. Such analyses of economic conditions in the industry contribute importantly to the Commission's decision-making processes.

To further improve its oversight of the operations of the securities markets during the fiscal year, the Commission implemented a pilot project phase of its Market Oversight and Surveillance System, which will provide the Commission a much enhanced capability to surveil the marketplace. In view of the increased volume and complexity of the securities markets, the Commission's existing approaches are no longer adequate. This system will supplement, not supplant, the market surveillance performed by self-regulatory organizations, in accordance with the Commission's strong commitment to the traditional framework of the securities industry's self-regulation.

Inspection and Enforcement

An essential medium for assuring compliance with the securities laws – and for assessing the impact of the Commission's regulation – is its inspection program, a responsibility which is receiving an enhanced emphasis although remaining understaffed. The Commission's inspection program of regulated entities – including self-regulatory organizations, broker-dealers, investment companies and investment advisers – provides a vital discipline and the opportunity to examine

the practical effects of regulation on such entities and on the investing public.

Moreover, in appropriate circumstances, the Commission in implementing its regulatory responsibilities, will initiate enforcement actions. The Annual Report relates some of the more significant enforcement actions concluded during the year. The Commission continues its longstanding commitment to such a vigorous enforcement program, which is necessary to the credibility of the Commission's programs to protect public investors and the integrity of the securities markets. This commitment has become even more compelling in recent years as court decisions have severely hampered the private rights of action by which investors themselves might otherwise have proceeded against perpetrators of illegal practices.

Accounting Matters

In response to its 1977 undertaking to a Senate Subcommittee to report periodically on the accounting profession's response in meeting its challenges, as well as the Commission's own initiatives in this area, the Commission, in July 1979, submitted its second Report on the Accounting Profession and the Commission's Oversight Role. The Report concluded that sufficient progress has been made to merit continued opportunity for the profession to pursue efforts at self-regulation.

In accordance with such efforts, the Commission continued its close liaison in support of the work of the Financial Accounting Standards Board to address emerging accounting problems, such as the effects of inflation on financial reporting. It strongly endorses the Board's program to develop an overall conceptual framework in which to consider such problems.

As part of its on-going responsibilities to oversee the accounting profession, in June 1979, the Commission issued a release concerning certain factors which may affect the independence of accountants in performing nonaudit services for publicly-held audit

clients, and certain factors which should be considered in determining to engage a corporation's independent accountants to perform nonaudit services. It also proposed during the year a rule requiring that management statements on internal accounting controls be included in corporations' annual reports on Form 10-K. Further, during the fiscal year, the Commission adopted amendments to certain forms and regulations to improve disclosure requirements relating to oil and gas reserves and operations, and proposed actions to encourage review by auditors of interim financial information.

This summary provides only a very brief synopsis of the significant activities in which the Commission is engaged throughout its operations. Among the many others are: the important role we play in assisting Federal courts with regard to shareholder interests in reorganizations of publicly-held companies; the installation of micrographic and computer systems which have brought to the Commission's information-handling procedures the benefits of current technology; and unprecedented efforts to employ effective evaluation, management and development capabilities to further enhance the quality of our most valuable resource – our staff. All of these efforts, and others, are covered in the pages of this Annual Report – whose format, incidentally, has been revised during the past two years into a slimmer, more readable and more timely document.

I believe that this is one of the most important periods in the Commission's nearly half-century of existence. The American corporate community, the securities industry, and the markets, themselves, are changing rapidly to meet the challenges of the 1980s. The Commission, working closely with the Congress which oversees our operations, with those in the private sector whom we regulate, and in the interests of investors, is also changing to meet these challenges. I have every confidence that the Commission will strive to perform its responsibilities with the professionalism and dedication which Congress and the investing public have come to expect.

Sincerely,
Harold M. Williams, Chairman

Commissioners and Principal Staff Officers
(As of December 31,1979)

Commissioners

HAROLD M. WILLIAMS of California, *Chairman* – Term expires June 5, 1982

PHILIP A. LOOMIS, JR., of California – Term expires June 5, 1984

JOHN R. EVANS of Utah – Term expires June 5, 1983

IRVING M. POLLACK of New York – Term expires June 5, 1980

ROBERTA S. KARMEL of New York – Term expires June 5, 1981

Secretary: **George A. Fitzsimmons**
Executive Assistant to the Chairman: **Daniel L. Goelzer**

Principal Staff Officers

Benjamin Milk, *Executive Director*

Edward F. Greene, *Director, Division of Corporation Finance*
Lee B. Spencer, *Deputy Director*
William C. Wood, *Associate Director*
Mary E. T. Beach, *Associate Director*
Michael J. Connell, *Associate Director*

Stanley Sporkin, *Director, Division of Enforcement*
(Vacant), *Deputy Director*[1]
Irwin M. Borowski, *Associate Director*
Theodore Sonde, *Associate Director*
David P. Doherty, *Associate Director*
Theodore A. Levine, *Associate Director*

Douglas S. Scarff, *Director, Division of Market Regulation*[2]
Sheldon Rappaport, *Deputy Director*
(Vacant), *Associate Director*
(Vacant), *Associate Director*
(Vacant), *Associate Director*

Sydney H. Mendelsohn, *Director, Division of Investment Management*
Martin C. Lybecker, *Associate Director*
Joel Goldberg, Associate *Director*

Aaron Levy, *Director, Division of Corporate Regulation*
Grant Guthrie, Associate *Director*

Ralph C. Ferrara, *General Counsel*
Jacob H. Stillman, *Associate General Counsel*
Robert C. Pozen, *Associate General Counsel*
(Vacant), Associate *General Counsel*

Paul Gonson, *Solicitor to the Commission*[3]

Andrew L. Rothman, *Director, Office of Public Affairs*
Chiles T. A. Larson, *Deputy Director*

A. Clarence Sampson, *Chief Accountant*
Steven J. Golub, *Deputy Chief Accountant*

Steven E. Levy, *Director of Economic and Policy Research*

William Stern, *Director, Office of Opinions and Review*
Herbert V. Efron, *Associate Director*
R. Moshe Simon, Associate *Director*

Warren E. Blair, *Chief Administrative Law Judge*

Lawrence H. Haynes, *Comptroller*

Richard J. Kanyan, *Director, Office of Administrative Services*

James C. Foster, *Director, Office of Personnel*

Joseph F. Olivo, Jr., *Director, Office of Reports and Information Services*

John D. Adkins, *Director, Office of Data Processing*

Justin P. Klein, *Director*, *Office of Consumer Affairs*[4]

Matthew R. Schneider, *Director of Legislative Affairs*

[1]Former Deputy Director, Wallace L. Timmeny, left the Commission on December 7, 1979.

[2]Former Director, Andrew M. Klein, left the Commission on October 12, 1979.

[3]Former Solicitor, David Ferber, retired from the Commission on September 28, 1979.

[4]Mr. Klein is now participating in the President's Executive Exchange Program and will return to the Commission in October 1980.

Regional and Branch Offices

Regional Offices and Administrators

Region 1. New York, New Jersey. – **Stephen L. Hammerman,** 26 Federal Plaza, New York, New York 10007.

Region 2. Massachusetts, Connecticut, Rhode Island, Vermont, New Hampshire, Maine. – **Willis H. Riccio,** 150 Causeway St., Boston, Massachusetts 02114.

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

Region 4. Illinois, Indiana, Iowa, Kansas City (Kansas), Kentucky, Michigan, Minnesota, Missouri, Ohio, Wisconsin. – **William D. Goldsberry,** Room 1204, Everett McKinley Dirksen Bldg., 219 S. Dearborn St., Chicago, Illinois 60604.

Region 5. Oklahoma, Arkansas, Texas, part of Louisiana, Kansas (except Kansas City). – Michael J. Stewart, 8th Floor, 411 West Seventh St., Forth Worth, Texas 76102.

Region 6. North Dakota, South Dakota, Wyoming, Nebraska, Colorado, New Mexico, **Utah. – Robert H. Davenport,** Suite 700, 410 Seventeenth St., Denver, Colorado 80202.

Region 7. California, Nevada, Arizona, Hawaii, Guam. – **Leonard H. Rossen,** Suite 1710, 10960 Wilshire Boulevard, Los Angeles, California 90024.

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

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

Branch Offices

Detroit, Michigan 48226. – 231 Lafayette St., 1044 Federal Bldg.

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

Miami, Florida 33131. – Suite 1114, DuPont Plaza Center, 300 Biscayne Boulevard Way.

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

Salt Lake City, Utah 84111. – Suite 810, Boston Bldg., One Exchange Place.

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

BIOGRAPHIES OF COMMISSIONERS

Harold M. Williams, *Chairman*

Chairman Williams was born on January 5, 1928, in Philadelphia, Pennsylvania. He received his B.A. from UCLA in 1946, graduating Phi Beta Kappa at the age of 18. Three years later he was awarded his J.D. degree from Harvard University Law School. He joined a Los Angeles law firm in 1949 where he specialized in tax and corporation law and remained until 1955 except for an interruption to serve as a *U.S.* Army legal officer during the Korean emergency. He joined Hunt Foods and Industries, Inc., in 1955 as Associate Tax Counsel. He subsequently became Tax Counsel, Vice President-Finance and Executive Vice President. In 1964, he became President of Hunt-Wesson Foods, Inc. In 1968, he was elected President of Hunt Foods and Industries, Inc., and with the formation of Norton Simon, Inc., later that year – resulting from consolidation of Canada Dry Corporation, Hunt Foods and Industries, Inc., and McCall Corporation – he was named Chairman of the new company's Finance Committee. In 1969, he assumed the additional post of Chairman of the Board of Norton Simon, Inc. In July of 1970, Mr. Williams became Dean and Professor of Management of the UCLA Graduate School of Management. During his administration, the School achieved national ranking, including recognition as the leading graduate business school in a public university. During the 1973 energy crisis, Mr. Williams took leave to serve as full-time Energy Coordinator for the City of Los Angeles. While at UCLA, Mr. Williams also served as Director of Norton Simon, Inc., Phillips Petroleum Company, ARA Services, Inc., CNA Financial Corporation, Signal Companies, Inc., and Montgomery Street Income Securities, and as a Trustee of the Aerospace Corporation. In his service to the community, Mr. Williams acted as Co-Chairman for the Public Commission on Los Angeles County Government, a subcommittee chairman of the Mayor's *ad hoc* Committee on Los Angeles City Revenues, a member of the State of California Commission for Economic Development and of the California Citizens Commission on Tort Reform, and a member of the SEC Advisory Committee on Corporate Disclosure.

Philip A. Loomis, Jr.

Commissioner Loomis was born in Colorado Springs Colorado, on June 11, 1915. He received an A.B. degree, with highest honors, from Princeton University in 1938 and an 11.B. degree, cum laude, from Yale Law School in 1941, where he was a Law Journal editor. Prior to joining the staff of the Securities and Exchange Commission, Commissioner Loomis practiced law with the firm of O'Melveny and Myers in Los Angeles, California. Commissioner Loomis joined the Commission's staff as a consultant in 1954, and the following year he was appointed Associate Director and then director of the Division of Trading and Exchanges. In 1963, Commissioner Loomis was appointed General Counsel to the Commission and served in that capacity until his appointment as a member of the Commission. Commissioner Loomis is a member of the American Bar Association and the American Law Institute. He received the Career Service Award of the National Civil Service League in 1964, the Securities and Exchange Commission Distinguished Service Award in 1966, and the Justice Tom C. Clark Award of the Federal Bar Association in 1971. He took office as a member of the Securities and Exchange Commission on August 13, 1971, and is now serving for the term of office expiring June 5, 1984.

John R. Evans

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

Exchange Commission on March 3, 1973, and is now serving for the term expiring June 5, 1983.

Irving M. Pollack

Commissioner Pollack was born in Brooklyn, New York, on April 8, 1918. He received a B.A. degree, cum laude, from Brooklyn College in 1938 and an 11.B. degree, magna cum laude, from Brooklyn Law School in 1942. Prior to joining the Commission's staff he engaged in the practice of law in New York City after serving nearly four years in the United States Army, where he gained the rank of Captain. Mr. Pollack joined the staff of the Commission's General Counsel in October 1946. He was promoted from time to time to progressively more responsible positions in that office and in 1956 became an Assistant General Counsel. A career employee, Mr. Pollack became Director of the Division of Enforcement in August 1972 when the SEC's divisions were reorganized. He had been Director of the Division of Trading and Markets since August 1965, and previously served as Associate Director since October 1961. In 1967 Mr. Pollack was awarded the SEC Distinguished Service Award for Outstanding Career Service, and in 1968 he was a co-recipient of the Rockefeller Public Service Award in the field of law, legislation and regulation. Mr. Pollack took the oath of office on February 13, 1974 as a member of the Securities and Exchange Commission, and is now serving for the term expiring June 5, 1980.

Roberta S. Karmel

Commissioner Karmel was born May 4, 1937, in Chicago, Illinois. She received a B.A. from Radcliffe College in 1959 and an 11.B. from New York University School of Law in 1962. From 1962 to 1969, Mrs. Karmel worked in the New York Regional Office of the Securities and Exchange Commission as an attorney, then attorney branch chief, then assistant regional administrator. From 1969 to 1972 she was an associate with Willkie, Farr & Gallagher in New York. Mrs. Karmel was a partner in Rogers & Wells from 1972 through September 1977, and an adjunct professor at Brooklyn Law School from 1973 through 1977. She has been a member of the American Bar Association

Federal Regulation of Securities Committee since 1973. She has also served on the Association of the Bar of the City of New York Committee on Securities Regulation, Committee on Administrative Law, and Committee on Professional Responsibility. She is the author of numerous articles in legal journals. Mrs. Karmel took the oath of office as a member of the Securities and Exchange Commission on September 30, 1977, for a term expiring on June 5, 1981.

Regulation of the Securities Markets

Securities Markets, Facilities and Trading

National Market System – The past fiscal year saw marked acceleration in progress toward the development of a national market system.

On October 20, 1978, the Commission published for comment two proposals designed to refine the operation of the consolidated transaction reporting and quotation systems. The first of these proposals, Rule 11Ac1-2 under the Securities Exchange Act of 1934 (Exchange Act), would, if adopted, impose comprehensive minimum requirements regulating the manner in which securities information vendors display transaction and quotation information.[1] The second proposal, the amendment of existing Rule 17a-15, would, if adopted, (a) redesignate Rule 17a-15asRule 11Aa3-1 under the Act; (b) eliminate, subject to certain conditions, the existing prohibition on retransmission of last sale data for purposes of creating a moving ticker display; and (c) set forth procedures for amending transactions reporting plans filed pursuant to the rules.[2] The Commission received many valuable comments from self-regulatory organizations and vendors of market information and at year end both proposals were awaiting further action.

On March 22, 1979, the Commission issued a Status Report which, among other things, set forth the Commission's views as to the next steps to be taken toward development of a national market system.[3] These steps included: achievement of nationwide price protection for all public limit orders; refinement of pilot market linkage facilities; improvement of the timeliness and reliability of quotation information; development of broker to market center order-routing facilities; consideration of a rulemaking proceeding to preclude the application of remaining off-board trading restrictions to securities not previously subject to those restrictions; and initiation of a rulemaking proceeding

to consider procedures by which securities would be designated as qualified for trading in a national market system.

In the Status Report, the Commission indicated that its first priority would be the achievement of nationwide protection for public limit orders against executions at inferior prices. The Commission expressed its belief that nationwide price protection, whereby any appropriately displayed public limit order for a qualified security would be assured of receiving an execution prior to any execution by a broker or dealer at an inferior price, should be a basic characteristic of a national market system. Furthermore, the Commission stated that, in addition to price protection for public limit orders, it may ultimately be desirable to afford price protection to all displayed orders at the market, whether public or professional, so that any displayed quotation would be entitled to price protection up to the quotation size indicated. As an initial step in this direction, the Commission indicated that the proponents of the Intermarket Trading System (ITS) should be afforded the opportunity to experiment with and further enhance that system as a means of providing intermarket price protection for public limit orders.

The Commission indicated that two types of initiatives would be necessary to achieve nationwide price protection for displayed public limit orders by means of the ITS. The first would require the self-regulatory organizations and the securities industry to resolve collectively the various practical and technical problems associated with (a) disseminating and displaying public limit order information from each market center and (b) promptly enhancing the ITS so that it may serve as a means by which price protection for public limit orders can be afforded on an intermarket basis. To this end, the Commission requested that the affected self-regulatory organizations commit themselves to develop in concert and to submit to the Commission a plan by which the mechanisms to provide price protection for all public limit orders would be developed and implemented, at least on a pilot basis, not later than the end of calendar year 1980. The second initiative would involve the proposal by the Commission of a rule requiring price protection for displayed public limit orders.

On April 26, 1979, the Commission proposed for comment Rule 11Ac1-3 under the Exchange Act which, if adopted, would prohibit any broker or dealer from executing any order to buy or sell a qualified security at a price inferior to the price of any public limit order displayed at the time of execution unless the broker or dealer assures that those limit orders are satisfied.[4] The following month, the Commission received a commitment from each reporting self-regulatory organization to develop a joint plan for protection of public limit orders. In September 1979, the ITS participants submitted a preliminary plan for the protection of public limit orders and a commitment to submit a definitive plan before the end of calendar year 1979. At the end of the fiscal year, the Commission was analyzing the preliminary plan and comments received in response to proposed Rule 11Ac1-3.

In furtherance of development of comprehensive market linkage systems, the Commission, on September 21, 1979, issued an order extending approval for operation of the ITS until January 31, 1983.' At the end of the fiscal year, all reporting self-regulatory organizations other than the Cincinnati Stock Exchange (CSE) and the National Association of Securities Dealers (NASD) were participating in the ITS. The Commission expects the CSE and NASD will commence participation in the ITS in the near future.

During the fiscal year, the number of securities traded in the ITS increased from approximately 100 to 600. That number is expected to continue to expand at the rate of approximately 40 securities per month. With expansion in the number of securities traded in the system, there has been a substantial increase in ITS volume. Furthermore, average response times with respect to ITS commitments to trade received by participating market centers have been reduced, and as a result of continuing technical enhancements to the system, the Commission expects that response times will be further reduced during fiscal year 1980.

On December 15, 1978, the Commission approved a rule change of the CSE extending the operation of the Cincinnati multiple-dealer trading facility (CSE System) for one year, and on September 21,

1979, the Commission further extended its approval until January 31, 1983.[6] While CSE System volume has thus far been limited, several additional broker-dealers commenced participation in the CSE System during the past fiscal year. The three-year extension and increased broker-dealer participation should facilitate the Commission's ability to evaluate the effects of trading in this type of system.

In the Status Report, the Commission indicated its belief that, both for purposes of enhancing brokers' ability to seek out the best execution of their customers' orders and for purposes of assuring fair competition among markets, some type of neutral order-routing system is a necessary element of a national market system. To assure progress toward this objective, the Commission requested the New York Stock Exchange (NYSE) and the American Stock Exchange (Amex) to make available their jointly-owned common message switch to other market centers; other self-regulatory organizations were asked to inform the Commission of their interest in obtaining such a linkage.

Since the Status Report, the NYSE has engaged in continuing discussions with several self-regulatory organizations with respect to use of the NYSE-Amex message switch. In addition, the NASD has proposed enhancements to its NASDAQ inter-dealer quotation system which would, among other things, create an order-routing switch in NASDAQ that could be linked to the NYSE-Amex message switch and to the ITS. The Commission will continue to monitor and to encourage progress in these areas.

On April 26, 1979, the Commission announced commencement of a proceeding to consider proposed Rule 19c-3 under the Exchange Act, which, if adopted, would limit extension of off-board trading restrictions to additional securities. The rule would preclude application of such restrictions to certain securities that were not traded on an exchange on April 26, 1979, or that were traded on an exchange on April 26, 1979, but failed to remain so there after.[7] In its release proposing Rule 19c-3, the Commission indicated its concern that, as companies continue to list their securities on exchanges that

have rules precluding their members from making over-the-counter markets in securities listed on those exchanges, competition between the over-the-counter market and the exchanges will be effectively foreclosed in an increasing number of securities. In addition, the Commission indicated that the rule could provide it and the securities industry with an opportunity to gain valuable experience as to the dynamics of competition between exchange-oriented trading and dealer-oriented trading. The Commission stated that the rule would also allow evaluation of whether existing and developing national market system facilities are sufficient to ensure an appropriate integration of trading in disparate locations.

During June and July 1979, the Commission held hearings with respect to proposed Rule 19c-3 and received extensive comments and testimony both supporting and opposing adoption of the rule. At the end of the fiscal year, the Commission was considering further regulatory action with respect to the rule.

Finally, on June 15, 1979, the Commission proposed for comment Rule 11Aa2-1 under the Exchange Act which, if adopted, would provide procedures whereby securities would be designated for trading in a national market system.[8] The proposed rule sets forth two quantitatively different sets of standards to be employed in determining whether any equity security should be designated a national market system security. The proposed rule would require that any equity security meeting certain minimum standards contained in the rule (tier 1 securities) be automatically designated a national market system security. If an equity security did not meet the standards applicable to tier 1 securities, but substantially met certain broader standards (tier 2 securities), it would remain eligible for designation as a national market security pursuant to the procedures set forth in a designation plan required to be filed with the Commission by the various self-regulatory organizations.

The standards applicable to tier 1 and tier 2 securities would cover both securities traded on an exchange and securities traded exclusively in the over-the-counter market. However, while the proposal provides that the rule will become operational upon adoption

with respect to all tier 1 securities and those tier 2 securities which are traded on an exchange, the rule will not become applicable to tier 2 over-the-counter securities until the Commission engages in further rule-making.

National System for Clearance and Settlement of Securities Transactions – During the fiscal year, substantial progress was made in the Commission's effort to foster development of a national system for clearance and settlement of securities transactions.

On September 19, 1978, the United States Court of Appeals for the District of Columbia Circuit affirmed the Commission's January 13, 1977 order granting the application of National Securities Clearing Corporation (NSCC) for registration as a clearing agency.[9] The Commission views the registration of NSCC as a key step in achieving the national clearance and settlement system envisioned by the Congress in Section 17A of the Exchange Act. Although the court did not disturb NSCC's registration, it did remand two issues to the Commission for further consideration: (a) NSCC's selection of Securities Industry Automation Corporation as the facilities manager of its consolidated system without competitive bidding; and (b) NSCC's use of geographic price mutualization (GPM). GPM is the practice of charging all participants the same fees regardless of whether the participants deal with the clearing agency at its main facility or through a branch office.

The Commission subsequently requested that NSCC submit reports on the two issues remanded by the court and that interested persons comment on NSCC's reports and on the GPM and competitive bidding issues generally.[10] By the end of the fiscal year, the Commission to date had received 11 letters in response to its request for comments, including letters from all but three of the registered clearing agencies. In preparation for responding to the court's remand, the Commission was reviewing those comment letters and the testimony and statements given at the Commission's March and April 1979 hearings into the development of a national clearance and settlement system.

On March 14, 1979, the Commission removed its restriction on NSCC's processing of transactions in securities listed on exchanges through its branch offices.[11] The removal of that restriction permitted NSCC's participants to process through NSCC's branch offices for the first time both transactions in securities listed on exchanges and transactions in securities traded in the over-the-counter market. The Commission indicated, however, that until it had responded to the remand of the GPM issue, NSCC could not use GPM for services relating to the processing of transactions in securities listed on exchanges.

The Commission continued its review of the transaction completion rules of the securities exchanges and of the NASD pursuant to Section 31(b) of the Securities Acts Amendments of 1975 (the 1975 Amendments). Some of those rules unnecessarily restricted competition among clearing agencies. Others failed to comply with the Exchange Act for other reasons. As a result of this review, over 120 exchange and NASD rules now have been amended or deleted. This step removed many impediments to the development of a national clearance and settlement system. The Commission is continuing to discuss the amendment or deletion of other transaction completion rules with the exchanges and the NASD.

Progress toward a national system also was evident in other areas. The continued expansion of interfaces among depositories has further immobilized securities certificates and allowed depository participants to use book entry transfers to make deliveries throughout the country. This reduces the need to physically move stock certificates to settle securities transactions among depository participants. In addition, The Depository Trust Company included certain types of municipal securities in its book entry system, thus bringing municipal securities into a book entry environment for the first time. These developments have reduced costs and accelerated the settlement process.

Options Trading – As previously reported,[12] since July 1977, there has existed, at the Commission's request, a voluntary moratorium on expansion of the standardized options markets, pending (a) the

completion of the Commission's Special Study of the Options Market (Options Study); (b) the evaluation of its findings; and (c) the resolution of the Commission's concerns regarding the adequacy of the regulatory framework within which standardized options trading occurs.[13]

The Report of the Options Study was released by the Commission in February 1979.[14] In general, the Study found that, to those who understand them, options may offer an alternative to short-term stock trading having lower commission costs and a smaller commitment of capital. They also may provide a means of shifting the risks of unfavorable short-term stock price movements from owners of stock who do not wish to bear those risks to those who are willing to assume such risks in anticipation of possible rewards from favorable price movements.[15] The Options Study stated, however, that the purchase and sale of standardized options involves a high degree of financial risk and that only investors who understand those risks and who are able to sustain the costs and financial losses associated with options trading should participate in the standardized options markets.

The Study found that, too often, public investors have been encouraged to use standardized options without regard to the suitability of options for their investment needs.[16] It also found regulatory inadequacies in the options markets and, accordingly, recommended certain steps that the brokerage community, the self-regulatory organizations and the Commission should take to improve the self-regulatory framework within which listed options trading occurs and to increase protection of investors.

On February 22, 1979, the Commission issued a release that set forth its plan for implementing the Options Study recommendations and for terminating the options moratorium.[17] The Commission stated that, before it would permit any further expansion of the options markets, certain recommendations of the Study must be implemented by the self-regulatory organizations and the brokerage community. Implementation of these recommendations generally would require the adoption of self-regulatory organization rules, and modifications

and improvements in the self-regulatory organizations' surveillance and compliance systems and procedures, as well as improved regulatory controls by brokerage firms. At the end of the fiscal year, the Commission had received rule proposals from the five exchanges trading options to implement some of the Options Study recommendations.[18]

On April 24, 1979, the Commission approved the combination of the Midwest Stock Exchange (MSE) options market with that of the Chicago Board Options Exchange (CBOE), to be effective upon termination of the options moratorium. Upon consummation of the combination, the MSE will no longer provide a market for listed options, and the CBOE will provide a market for those options then listed on the MSE. Upon listing the MSE options classes, the CBOE will assume full responsibility for floor operations, surveillance and enforcement regarding trading in those options classes.[19]

As reported previously,[20] on October 18, 1978, the Commission approved a four-month experiment by the options exchanges to extend trading hours until 4:10 p.m. New York time and to suspend daily closing rotations.[21] On April 27, 1979, the Commission approved uniform rule proposals by the options exchanges to permit, on a permanent basis, options transactions to be effected on the exchanges until 4:10 p.m. New York time and to provide that one trading rotation in any class of options may be completed where trading in the underlying security opens or reopens after 3:45 p.m. New York time, even though completion of the rotation may occur after 4:10 p.m. New York time.[22] On July 11, 1979, the Commission approved a second exception to the 4:10 p.m. closing time which provides that, if a trading rotation is commenced near the close of trading because of unusual market conditions, such as a heavy influx of orders, an options exchange can permit the rotation to be completed after 4:10 p.m. New York time if notice of the rotation is publicly disseminated no later than the commencement of the rotation or 4:00 p.m. New York time, whichever is earlier.[23] The Commission has deferred further consideration of certain related rule proposals until additional experience is gained respecting the 4:10 p.m. closing hour and the exceptions described above.

Market Inventory Funds – In October 1978, the Chairman submitted to Senator Harrison A. Williams, Jr. a staff report on market inventory funds, which are part of master trusts established by companies to fund and administer employee benefit plans. Market inventory funds have been used solely in connection with plans of individual companies rather than in connection with pooled benefit plans of separate companies. The staff found no clear indication that these funds, as they had been operated up to that time, had had an adverse impact upon the securities markets. The report concluded, however, that such funds could develop a broad appeal in the future and that it would be appropriate for the Commission and its staff to continue to evaluate the operation of market inventory funds and their impact on the securities markets.

Trading by Exchange Members – Section 11(a)(1) of the Exchange Act, as amended in 1975, prohibits, with specified exceptions, any member of a national securities exchange from effecting any transaction on that exchange for its own account, the account of an associated person, or an account with respect to which it or any of its associated persons exercises investment discretion. Under this section, the Commission has authority to fashion either more flexible or more restrictive standards in light of changing circumstances. Section 11(a) became effective as to all exchange members on February 1, 1979.

In January 1979, the Commission announced the adoption of (a) a temporary rule permitting exchange members to effect certain bona fide hedge transactions for their own accounts or the accounts of their associated persons; (b) interpretations concerning the application of the section to transactions effected through the use of several automated facilities operated by national securities exchanges; and (c) interpretations concerning certain exemptions for specified types of proprietary transactions effected by exchange members.[24] Also in January 1979, in connection with its continuing review of its regulatory program under Section 11(a), the Commission commenced two surveys designed to elicit data concerning (a) the effect of the section on exchange members that provide money

management and brokerage services to discretionary institutional accounts, and (b) market making activities by certain exchange members.

In July 1979, the Commission also approved a nine-month extension, until April 30, 1980, of programs designed by the NYSE and the Amex to supplement the market making capacity of specialists by establishing classes of registered market makers whose transactions are exempted from the prohibitions of the section.[25] During the nine-month period, the Commission will continue its review of the activities of those registered market makers to determine whether their transactions should continue to qualify for an exemption.

Effects of the Absence of Fixed Commission Rates – In May 1975, the Commission prohibited the national securities exchanges from prescribing fixed minimum commission rates to be charged by their members. Later that year, the Congress enacted a similar prohibition as part of the 1975 Amendments. Pursuant to that legislation, the Commission submitted to the Congress five reports covering the first 20 months of commission price competition (through December 31, 1976), describing the effects of the unfixing of commission rates on the maintenance of fair and orderly markets and on the development of a national market system for securities.

Analysis of commission rates is now integrated into the Commission's ongoing monitoring of the financial condition of the industry. In that connection, the Commission's Directorate of Economic and Policy Research released to the public on July 26, 1979, a "Staff Report on the Securities Industry in 1978" (Staff Report), which detailed the results of its commission rate survey in the context of a wide-ranging analysis of the basic economic dynamics of the securities industry. This Staff Report is the second in a continuing series of annual reports designed to provide the Commission with an economic basis for anticipating the impact of regulatory changes upon the securities industry, investors and the broader economy. Beginning with the 1978 Staff Report, the Directorate greatly expanded the scope of its study of the securities industry to examine fundamental industry trends and relationships in addition to the impact of negotiable

commission rates. The 1978 Staff Report analyzed, for example, the profitability of New York Stock Exchange member firms, the sources of and trends in revenues of these firms, firm expenses and balance sheet data, the trend toward and causes of increased concentration in the securities industry, the increasing diversification among the larger broker-dealers, the notable growth of discount broker-dealers, the financial experience of exchange specialists, the economic performance of self-regulatory organizations, and, of course, the economic effects of unfixed brokerage commission rates.

In general, the reports to the Congress and the two Staff Reports concluded that competitively determined commission rates do not appear to have adversely affected the maintenance of fair and orderly markets. Some of the more specific findings in regard to commission rates are as follows.

From May 1, 1975 to the end of June 1979, individual investors' effective commission rates, when measured as a percent of principal value, declined 19.7 percent. Institutional customers, because of their larger average order size and greater bargaining power, have negotiated discounts averaging 53.6 percent from the pre-May 1975 exchange-prescribed minimum rates. When commission rates are measured in cents per share, the declines were eight percent for individuals and 53.8 percent for institutions. Individuals paid an average of 27.6 cents per share on their June 1979 orders, which averaged 400 shares in size. Institutional orders averaged 2,034 shares in size and commissions on these orders averaged 12.0 cents per share. Individual orders of 1,000 shares or more showed commission rate discounts comparable to similarly sized institutional orders.

Broker-dealers were affected by the elimination of fixed minimum commission rates largely depending upon the extent to which they served institutional investors. Some firms which did a large portion of their total business with institutions have merged with more diversified firms or have gone out of business, and a new group of discount broker-dealers have entered the industry. On the whole,

these changes now offer investors a broader spectrum of services with a correspondingly broader range of commission rates.

Regulation of Tender and Exchange Offers by Issuers – On August 16, 1979, the Commission announced the adoption of a new Rule 13e-4 and related Schedule 13E-4 under the Exchange Act, effective September 21, 1979, to regulate the increasing number of cash tender and exchange offers by certain issuers for their own securities.[26] Rule 13e-4 and Schedule 13E-4 had been proposed for public comment on December 4, 1977.[27]

Rule 13e-4 requires that (a) issuers with a class of equity securities registered under Section 12 of the Exchange Act; (b) issuers required to file periodic reports pursuant to Section 15(d) of the Exchange Act; and (c) closed-end investment companies registered under the Investment Company Act of 1940 comply with certain disclosure requirements and other provisions governing the manner in which cash tender and exchange offers may be made. The requirements of the rule are patterned substantially on the regulatory scheme established by Section 14(d) of the Exchange Act and existing rules thereunder which are applicable in the context of third party tender offers. The information required to be disclosed in Schedule 13E-4 is substantially the same type of information which is required by Schedule 14D-1. The Commission adopted Rule 13e-4 and Schedule 13E-4 to insure that issuer tender offers are conducted in a manner free of deception, manipulation or fraud.

Resale of Restricted Securities – On August 2, 1979, the Commission authorized the issuance of a release[28] setting forth the staff's views concerning certain issues raised by the resale of restricted and other securities in compliance with Rule 144 under the Securities Act of 1933 {Securities Act). The release responded to interpretive questions raised by the amendments to that rule adopted by the Commission in September 1978,[29] which, among other matters, permit sales under the rule to be made directly to a market maker and liberalize restrictions on the amount of securities which may be resold under the rule.

Regulation of Brokers, Dealers and Municipal Securities Dealers

Regulatory Burdens on Small Brokers and Dealers – The Commission is aware of the need to evaluate the costs and competitive impact of its regulations on brokers and dealers. Accordingly, in adopting regulatory requirements, the Commission weighs the benefits to investor protection and other statutory goals against possible compliance and competitive burdens. In addition, the Commission endeavors to tailor regulatory requirements to particular business practices so as to avoid imposing unnecessary regulatory burdens. This effort can particularly benefit smaller, more specialized brokerage firms.

Lost *and Stolen Securities* – During fiscal 1979, several significant developments occurred in the Commission's Lost and Stolen Securities Program. On November 1, 1978, the Commission announced the redesignation of Securities Information Center, Inc. (SIC) as the Commission's designee to maintain and operate the data base of missing, lost, counterfeit and stolen securities for a two-year term commencing January 1, 1979.[30] In addition, the Commission, on March 29, 1979, published for public comment various proposed amendments to the Commission rule governing the program.[31]

In response to comments received, the Commission, on May 23, 1979, adopted amendments to the rule[32] which, among other things: (a) established registration requirements for all institutions subject to the rule (reporting institution) with certain exceptions; (b) required that losses and thefts of securities of the United States Government and its agencies be reported to SIC, instead of the Federal Reserve Banks, in an identical manner as lost, stolen or counterfeit corporate and municipal securities; (c) incorporated into the rule the temporary pilot period exemptions from reporting and inquiry; (d) established a new exemption from required inquiry for bearer securities received by a reporting institution directly from a known customer to whom it had previously sold the securities; and (e) required reporting institutions to report suspect counterfeit securities to a transfer agent for the issue.

The rule also incorporated two staff interpretations which exempt from required inquiry (a) securities received by a reporting institution directly from a "drop" that is affiliated with another reporting institution for the purposes of receiving and delivering certificates on behalf of such institution; and (b) securities received from a Federal Reserve Bank or Branch. At the end of August 1979, approximately 395,000 reports of missing, lost, counterfeit or stolen securities, with an aggregate market value of nearly $2.1 billion, had been received by SIC since the inception of the program on October 3, 1977.

Securities Confirmations – On December 18, 1978, the Commission's new rule prescribing delivery and disclosure requirements for securities transaction confirmations sent by brokers and dealers to customers became generally effective.[33] The confirmation is an important disclosure document that provides an investor with information pertinent to each securities transaction. For example, the disclosures required in the confirmation provide investors with a basis for comparing transaction costs offered by competing broker-dealers and for measuring those costs against the quality of brokerage services provided.

In October 1978, before the effective date of the rule, the Commission adopted amendments[34] requiring disclosures relating to odd-lot differentials, remuneration received in "risk-less" principal transactions in equity securities, and market making activities. Also, in October 1978, the Commission announced proposals to amend the confirmation rule further and to adopt a new rule extending to transactions in debt securities the required disclosures of remuneration received in riskless principal transactions.[35] At the end of fiscal year, the Commission was evaluating the public comments received in response to those proposals to determine whether the additional disclosure requirements are appropriate.

Uniform Dispute Resolution Procedures for Investors – A program to implement uniform, fair and efficient dispute resolution procedures for investors was undertaken by the Commission in May 1976, in connection with its establishment of an Office of Consumer Affairs. The Securities Industry Conference on Arbitration (SICA), a voluntary

group of securities industry and public representatives, submitted proposals for a uniform dispute resolution system contemplating utilization of existing arbitration facilities. Self-regulatory organizations adopted a series of rules based on SICA proposals providing procedures for small claims arbitration which were approved by the Commission during the fiscal year 1978. The Commission reviews the operation of arbitration facilities as part of its general oversight responsibilities with respect to self-regulatory organizations.

On December 28, 1978, SICA submitted further proposals for a uniform arbitration code for investor-broker disputes. The uniform code includes provisions that are intended to improve the efficiency and fairness of arbitration procedures provided by self-regulatory organizations. For example, a record of the proceedings would be kept upon request, the majority of arbitrators on each panel would not be associated with the securities industry and peremptory challenge of arbitrators by either party would be allowed. In addition, parties would be directed to cooperate in the voluntary exchange of documentary evidences and would be permitted to forward documents to the arbitrators prior to the hearing in order to expedite the proceedings.

Arbitration Clauses in Broker-Dealer Customer Agreements – Despite its support for arbitration, the Commission became concerned during the fiscal year about the fact that many customer agreement forms used by broker-dealers contain clauses purporting to require arbitration of all future disputes that might arise between the securities professional and the customer. In general, broker-dealers did not inform customers that a number of court decisions have held such advance agreements to be unenforceable with respect to causes of action arising under the Federal securities laws. Without such information, customers might be led to believe that they had prospectively waived any right to a judicial forum for the resolution of disputes related to securities transactions.

In July 1979, the Commission published a release[36] giving notice to broker-dealers that the use of pre-dispute arbitration clauses in customer agreement forms, without specifying the meaning, effect

and enforceability thereof, is inconsistent with just and equitable principles of trade and may raise serious questions of compliance with the antifraud provisions of the Federal securities laws. The Commission emphasized its support for arbitration as a means of resolving disputes between investors and securities professionals, but stated that prior agreements to arbitrate must reflect current applicable judicial decisions.

Municipal Securities Dealers – On July 11, 1979, the Commission published for comment proposed amendments to Rule 15blO-12 under the Exchange Act, allowing an exemption for certain municipal securities brokers and municipal securities dealers from the requirements of the Commission's SECO (Securities and Exchange Commission Only) program.[37] The proposed amendments are designed to eliminate the current dual regulation of municipal securities transactions effected by SECO brokers and dealers which conduct business in both municipal and corporate securities.

During the fiscal year, the Commission, pursuant to Section 17(b) of the Exchange Act, conducted one joint examination of a bank municipal securities dealer.

Broker-Dealer Financial Responsibility Requirements – Many broker-dealers subject to the Commission's uniform net capital rule are also registered with the Commodity Futures Trading Commission (CFTC) as futures commission merchants (FCMs). An FCM is, generally, a person who engages in soliciting or in accepting orders for the purchase or sale of any commodity for future delivery on or subject to the rules of any contract market.[38] The CFTC has jurisdiction to impose minimum financial requirements on FCMs. On September 1, 1978, the CFTC substantially revised its minimum financial and related reporting requirements imposed upon registered FCMs, which became effective on December 20, 1978.[39] Although the CFTC's amendments apply only to FCMs, about half of all commodity customer business in the futures industry is done by FCMs that are also registered with the Commission as securities broker-dealers and are therefore subject to the Commission's uniform net capital rule.

In the interest of minimizing duplicative regulation, the CFTC generally incorporated into its minimum financial responsibility rules provisions comparable to the Commission's net capital requirements applicable to the securities business of an FCM. The CFTC agreed to accept Part 11 of the Financial and Operational Combined Uniform Single (FOCUS) Report, a quarterly report filed by broker-dealers with the Commission, provided it was amended to incorporate the CFTC's Schedule of Segregation Requirements and Funds on Deposit in Segregation.

On June 5, 1979, the Commission generally incorporated into its net capital rule the CFTC's minimum financial requirements applicable to the commodities business of an FCM.[40] It also incorporated the CFTC's segregation schedule into its FOCUS Report.[41] The joint efforts of the two agencies have generally provided uniform net capital requirements for entities involved in both the securities and commodities businesses and will eliminate duplicative reporting requirements.

Securities Investor Protection Corporation – The Securities Investor Protection Act of 1970 (SIPA)[42] provides certain protection to customers of brokers and dealers that fail to meet their obligations to their customers. SIPA is administered principally by the Securities Investor Protection Corporation (SIPC), a nonprofit membership corporation, the members of which are all registered brokers and dealers with limited exceptions. SIPC is funded through assessments on its members, although it may borrow up to $ 1 billion from the United States Treasury under certain emergency conditions. Section 3(e) of SIPA requires that SIPC file proposed rule and bylaw changes with the Commission. Proposed rule changes must be approved by the Commission before they become effective, while proposed bylaw changes take effect after a prescribed period unless the Commission disapproves the bylaw changes.

On September 20, 1978, SIPC submitted proposed bylaw changes regarding the indemnification of SIPC directors, and requiring SIPC members to display the SIPC symbol at their offices and to make reference to their SIPC membership in certain advertisements. The

Commission considered these proposals on November 8, 1978 and did not disapprove them.

In June 1978, SIPC adopted and submitted to the Commission three sets of rules under SIPA. The Series 100 rules and the Series 200 rules establish various capacities in which a customer may have separate securities accounts with a single broker-dealer and be protected by SIPC on each account. The Series 300 rules set forth requirements for the closeout and completion of open contractual commitments between a SIPC member undergoing liquidation and other broker-dealers. In October 1978, the Commission approved the Series 100 and 200 rules.[43] Subsequently, in March 1979, the Commission approved the Series 300 rules.[44] The Series 300 rules replaced similar Commission rules that were promulgated before the passage of the Securities Investor Protection Act Amendments of 1978 which gave SIPC, rather than the Commission, the authority to adopt such rules.

Because SIPC rules approved by the Commission have the same force and effect as Commission rules, the Commission has published those rules in a separate section of the *Code of Federal Regulations.*

Oversight of Self-Regulatory Organizations

Securities Exchanges – As of September 30, 1979, ten exchanges were registered with the Commission as national securities exchanges pursuant to Section 6 of the Exchange Act: American Stock Exchange (Amex); Boston Stock Exchange (BSE); Chicago Board Options Exchange (CBOE); Cincinnati Stock Exchange (CSE); Intermountain Stock Exchange (ISE); Midwest Stock Exchange (MSE); New York Stock Exchange (NYSE); Pacific Stock Exchange (PSE); Philadelphia Stock Exchange (Phlx); and Spokane Stock Exchange (SSE). No exchange is currently operating under an exemption from registration as a national securities exchange.

In connection with the Commission's oversight of the delisting of securities traded on national securities exchanges, the Commission,

during the fiscal year, granted applications by exchanges to strike 96 equity issues and 56 debt issues from listing and registration. The Commission also granted applications, submitted by issuers, requesting withdrawal from listing and registration for 24 equity issues and four debt issues.

During the fiscal year, the Commission neared completion of its review of its policies with respect to granting applications for unlisted trading privileges. The Commission's review is designed to develop standards which it will apply in considering whether an extension of unlisted trading privileges is consistent with the maintenance of fair and orderly markets and the protection of investors under Section 12(f)(2) of the Exchange Act. While that review continues, the Commission generally has not granted applications for unlisted trading privileges. In June[46] and again in August[47] of the fiscal year, however, the Commission approved applications by the MSE for unlisted odd lot trading privileges in certain securities which had become listed on the NYSE subsequent to the date of a previous Commission order extending unlisted odd lot trading privileges to the MSE in 865 NYSE-listed securities.[48]

During the fiscal year, the national securities exchanges reported to the Commission, pursuant to Section 19(d)(1) of the Exchange Act, approximately 200 disciplinary actions imposing a variety of sanctions upon member firms and their employees. In addition, the Commission received from the national securities exchanges 154 filings pursuant to Rule 19b-4 under the Exchange Act, including 98 proposed rule changes and 56 notices of *a* stated policy, practice or interpretation not constituting a rule change. Among the significant rule filings approved by the Commission during the fiscal year were: (a) a proposal by the NYSE to establish, on a two-year pilot basis, a non-disciplinary procedure for the reallocation of securities among specialist units who fail to meet certain minimum performance standards based upon the results of a performance evaluation questionnaire[49]; (b) a complete revision of the rules of the CSE[50]; (c) amendments to the Amex listing standards, expanding the universe of foreign and domestic issuers whose securities may qualify for listing on the Amex[51]; (d) a nine-month extension of the respective

NYSE and Amex rules regarding supplemental market makers in equity securities[52]; and (e) a pricing formula amendment to the PSE's automated execution system (COMEX), to provide that orders executed at the best bid or best offer as determined by quotes received from all participants in the Intermarket Trading System.[53]

National Association of Securities Dealers – The NASD is the only securities association registered with the Commission. At the close of the fiscal year, 2800 brokers and dealers were NASD members.

During the past fiscal year, the NASD reported to the Commission the final disposition of 289 disciplinary complaints. In those disciplinary actions, 143 member firms and 332 individuals were named as respondents. At the beginning of fiscal 1979, three proceedings for review of NASD disciplinary decisions were pending before the Commission, and during the year 27 additional cases were brought up for review. The Commission reviewed 14 of these cases and reduced the sanctions to be imposed in some cases.

The Commission also reviewed 39 NASD applications to admit a broker or dealer to membership or to permit a person to become associated with a member where the broker or dealer or person is subject to a statutory disqualification. The Commission has taken no adverse action with respect to 15 notices. Five notices were withdrawn, and at the end of the fiscal year, 19 notices were pending before the Commission.

During the year, the Commission continued to review an NASD proposed rule submitted in fiscal 1978 to prohibit its members from giving discounts to customers in distributions of securities offered at a fixed price. The proposal was written in response to a 1976 judicial decision, *Papilsky v. Berndt,*[54] which held that such discounts were unlawful in some circumstances, absent a contrary Commission or NASD ruling. In September 1979, the Commission commenced public hearings to consider the issues presented by the proposed rule.

During the fiscal year, the Commission also worked with self-regulatory organizations to simplify and eliminate duplication in the self-regulatory system for brokers and dealers. The Commission extended until January 1, 1980, its provisional approval of four plans proposed by self-regulatory organizations for allocating their responsibilities to perform various regulatory functions for brokers and dealers which belong to more than one self-regulatory organization. The plans represent agreements reached between the NASD and four exchanges: the BSE, CSE, MSE and PSE. The plans assign to the NASD much of the responsibility for conducting onsite examination of dual members and for processing various applications.

Municipal Securities Rulemaking Board – As in the case of national securities exchanges and the NASD, the Commission reviews proposed rule changes of the Municipal Securities Rulemaking Board (MSRB). During the fiscal year, the MSRB filed 14 rule proposals. The Commission considered a number of those proposals and others which were pending from the previous fiscal year.

The Commission approved a comprehensive arbitration code for the municipal securities industry.[55] The code is designed to provide a means for resolving disputes on an expedited and relatively inexpensive basis. It includes both special procedures for settling disputes relating to customer small claims and more general procedures which can be used for claims of any size.

The Commission also approved a rule relating to the advertising of municipal securities.[56] The rule prohibits a municipal securities professional from publishing or causing to be published an advertisement concerning municipal securities that such professional knows or has reason to know is false and misleading. It also requires all advertisements concerning municipal securities to be approved in writing by appropriate supervisory personnel.

In addition to consideration of MSRB rule proposals, the Commission proposed a rule to provide the MSRB with information for use in its rulemaking activities. On May 30, 1979, the Commission published

for comment proposed Rule 15Bc7-1 under the Exchange Act to make available to the MSRB information concerning compliance examinations of municipal securities brokers and municipal securities dealers.[57] The proposed rule is designed to establish a mechanism for furnishing to the MSRB reports of compliance examinations, or information from such examinations, made by or furnished to the Commission, the NASD and the three Federal bank regulatory agencies. (In October 1979, this rule was adopted by the Commission.[58])

Clearing Agencies – The Commission has granted temporary registration to 12 clearing agencies pending the development of standards for full registration of clearing agencies. The Commission also received applications for temporary registration as a clearing agency from the Philadelphia Depository Trust Company (Philadep) and the Fixed Income Clearing Corporation.[59]

The Commission, at year end, was considering the numerous comment letters which were received on the revised proposed standards for clearing agency registration which were published in the previous fiscal year.[60] The Commission expects to announce the standards for full registration within the next fiscal year.

The Commission has established a Branch of Securities Processing Inspections whose primary responsibility is to inspect registered clearing agencies. The branch has embarked on a program of inspecting each clearing agency and is developing formal procedures for the inspection of clearing agencies. On July 10-13, 1979, the branch conducted an extensive inspection of the Philadep as part of the Commission's consideration of whether to grant temporary registration as a clearing agency to that applicant. At the end of the fiscal year, the Commission's staff was continuing to analyze data gathered in the course of this inspection. After completion of this work, the findings of this inspection will be discussed with Philadep. (Subsequent to the close of the fiscal year, on October 24, 1979, the Commission announced its order granting temporary registration to Philadep.[61])

Arbitration Facilities of Self-Regulatory Organizations – During fiscal year 1978, the Commission's staff inspected arbitration facilities of the NASD, Amex, and CBOE. The staff also completed its analysis of information obtained during an inspection of the NYSE on September 27-28, 1978. The purpose of these inspections was to determine the efficiency and fairness of the procedures of these organizations for the resolution of disputes between investors and broker-dealers. The inspections focused on the organizational structure of the arbitration departments, the composition of arbitration panels, the time necessary to resolve disputes, the volume of cases and the range of awards.

As a result of these inspections, the staff recommended that the self-regulatory organizations prepare materials to inform investors about the enforce-ability of agreements to arbitrate future disputes with broker-dealers and about those issues for which a judicial forum might be available. The staff also made certain comments and recommendations regarding the operation of the arbitration programs.

The staff suggested that the NYSE permit arbitrators, through the arbitration department staff, to refer to disciplinary authorities any apparent violations of applicable rules or laws discovered in the course of arbitration proceedings. The staff also suggested that the NASD attempt to reduce the time between filing and resolution of claims and to select public arbitrators with a greater diversity of experience.

Procedures for Filing Proposed Rule Changes – Section 19(b) of the Exchange Act, as amended by the 1975 Amendments, requires self-regulatory organizations to file all proposed rule changes with the Commission. Shortly after Section 19(b) became effective, the Commission adopted Section 19b-4 and related Form 19b-4A establishing procedures for self-regulatory organizations to file proposed rule changes and designating the types of proposed rule changes that may become effective upon filing.

In May 1979, the Commission proposed for public comment amendments to Rule 19b-4 and related Form 19b-4A.[62] Developed in

light of the Commission's experience in administering Section 19(b), the proposed amendments are intended to improve and simplify the procedures for filing proposed rule changes, thereby expediting the rule review process. The Commission's proposals include (a) an amendment to Rule 19b-4 to designate a new category of rules that may become effective upon filing and (b) amendments to Form 19b-4A to specify, in greater detail the information required by that form.

Inspections of Self-Regulatory Organizations – During the fiscal year, the Commission reorganized its program for oversight inspections of the activities of self-regulatory organizations. This new program has entailed more frequent and more intensive onsite inquiries into the market surveillance and compliance systems of the various national securities exchanges and the NASD.

In February 1979, the Commission staff conducted an inspection of the stock market surveillance program of the Phlx. This inspection disclosed significant inadequacies in the market surveillance systems of the Phlx.

In April 1979, the Commission staff, in response to a recommendation of the Options Study, conducted an inspection of the operations and listed options market surveillance program of the MSE. This inspection disclosed that the MSE program was inadequate for the detection of certain common options trading violations.

In June 1979, the Commission staff, in connection with a pending pilot trading program, conducted an inspection of the NYSE program for surveillance of the activities of Registered Competitive Market Makers (RCMMs) and Registered Competitive Traders (RCTs). This inspection also included a review of the exchange's enforcement program for RCMM members. This inspection disclosed deficiencies in certain of the techniques employed by NYSE staff to detect rule violations by RCMMs and RCTs and other weaknesses in case file documentation practices. Also discovered was a failure to take the formal disciplinary action necessary to enforce RCMM rules effectively.

In April 1979, the Commission staff inspected the options operations and market surveillance programs of the PSE. This inspection disclosed certain inadequacies in some of the exchange's systems which monitor compliance by market professionals with trading rules and with credit regulations.

In June 1979, the Commission staff conducted an inspection of the options operations and market surveillance systems of the Phlx. This inspection disclosed significant deficiencies in the Phlx system to detect options trading violations and deficiencies in the enforcement of certain Phlx rules. In June 1979, the Commission staff conducted an inspection of the Securities Qualification Section in the NASD's NASDAQ Operations Department. The major findings of this inspection were that the NASD had made marked improvements in the manner in which it monitors periodic filings of issuers for compliance with securities qualification criteria, that there were shortcomings in the section's administration of the listing exception process and that there were ambiguities in the NASD rules governing this process.

Between February and July 1979, the Commission staff conducted inspections of the operations of NASD district offices located in Philadelphia, Washington, D.C., New Orleans, Kansas City and Chicago, as well as the operations of the unit at NASD headquarters assigned to manage and coordinate NASD district office activities. These inspections focused on the administration of the NASD's program of examinations and monitoring of member firms. These inspections disclosed a number of strengths and weaknesses in the regulatory programs of individual offices as well as several significant weaknesses which appeared to be national in scope. This latter class of weaknesses included (a) shortcomings in the work paper requirements and document maintenance practices of NASD examiners, especially with regard to sales practices; (b) the failure of some examiners to follow procedures prescribed by the NASD to detect sales practice violations during routine examinations of member firms; and (c) inadequate staffing of the district offices of both examiners and supervisory personnel.

During July 1979, the Commission staff inspected the operations and market surveillance and enforcement program of the CBOE. The inspection team found inadequacies in the manner in which the CBOE seeks to detect certain trading violations.

During August 1979, the Commission staff inspected the options operations and market surveillance and enforcement program of the Amex. This inspection disclosed certain deficiencies in the market surveillance systems of the exchange and a failure to enforce certain exchange rules. !n addition, the inspection team found a pattern of failure to prosecute certain cases of apparent rule violations by floor members.

During February 1979, the Commission staff conducted an examination of the complaint processing unit of the Amex. Complaint processing is a function of the Department of Rulings and Inquiries, Legal and Regulatory Policy Division, which is also responsible for issuing interpretations of Amex rules. The purpose of the inspection was to determine the responsiveness, efficiency and timeliness of the Amex complaint handling system. The staff will continue to monitor that system and to recommend changes where necessary.

In May 1979, the Commission staff examined the complaint processing function of the CBOE. The CBOE Trading Regulation Department responds to complaints and inquiries which are floor-related, and the Office of Inquiries and Complaints handles matters related to broker-dealer sales practices. The staff will continue to monitor the responsiveness of the CBOE to investor concerns.

After each of the foregoing inspections, the Commission notified the appropriate self-regulatory organization of its findings and asked that remedial action be taken. The Commission is planning a series of follow-up inspections to ensure that appropriate remedial action has been taken.

Revenues and Expenses of Self-Regulatory Organizations – The regulatory functions of the various exchanges and the NASD with

regard to their broker-dealer members are financed through various fees and dues, such as listing fees and transaction charges. The nature of some of these revenue sources makes the financial condition of self-regulatory organizations dependent upon price fluctuations and trading volume.

Furthermore, the various self-regulatory organizations are quite different in the extent of their dependence on particular sources of revenue. Some sources of revenue, such as transaction, clearing and depository fees, change directly with changes in share volume. Others are relatively fixed, such as listing fees and membership dues. Additional analysis and statistical detail on share volume, revenues and expenses of each self-regulatory organization are presented in the Appendix of this report.

The Disclosure System

New Developments in Disclosure Policy

The "full disclosure" system administered by the Commission is designed to assure that the securities markets operate in an environment in which full and accurate material information about publicly traded companies is available to all interested investors. During the fiscal year, the Commission pursued a program designed to enhance the effectiveness of required information, while reducing attendant burdens to the extent possible. Five major objectives have been stressed to attain that goal: (1) Integration of disclosures required by the Securities Act of 1933 (Securities Act) and the Securities Exchange Act of 1934 (Exchange Act); (2) narrowing of the differences between information supplied by registrants to the Commission in formal filings and to various segments of the public through informal means; (3) improvement of disclosure requirements; (4) development of guidance for special situations outside the normal system of continual disclosure; (5) refocusing of the staff review process; and (6) implementation of a program review of existing rules to delete or amend unnecessary or outmoded provisions.

Projections of Future Economic Performance – In furtherance of its new policy of encouraging the disclosure of earnings forecasts and other forward-looking information by registrants, the Commission issued a release on June 25, 1979, which announced the adoption of Rule 175 providing "safe harbor" from the liability provisions of the Federal securities laws for enumerated forward-looking information that is reasonably based and made in good faith.[63] The Commission's initiatives in voluntary projection disclosure are experimental in nature and a task force has been set up to assure that the new policies embodied in the rule do not yield results inconsistent with investor protection.

Disclosure Revisions – The Commission has taken a number of steps to improve the format of disclosure, delete unnecessary requirements, add new requirements, and, generally, make disclosure more effective and flexible. In one such action, the Commission adopted amendments to provide relief from certain portions of the reporting requirements of the annual and quarterly reports filed with it by registrants whose equity securities are owned either directly or indirectly by a single person which itself is a reporting entity under the Exchange Act.[64] The Amendments are part of the Commission's continuing effort to reduce reporting burdens and paperwork by more precisely tailoring the reporting requirements to the characteristics of particular registrants and to the needs of their investors.

On September 6, 1979, the Commission proposed the amendment of Rule 12b-25 and its related form which would result in the elimination of extensions of time to file reports under the Exchange Act and, in lieu thereof, proposed the institution of a system requiring notification of a registrant's or reporting person's inability to timely file reports or portions thereof.[65] By eliminating the review requirement for extension of time requests, the Commission hopes to be able to place increased emphasis on the review of all Exchange Act filings. In this manner, the Commission will attempt to implement a recommendation of the Advisory Committee on Corporate Disclosure which noted that a substantive review of periodic reports, consistent with the quality of information sought in registration statements, is essential to the end product of a high quality disclosure document.[66]

The Commission also concurrently proposed for comment a new Rule 12b-26 which would require registrants to prominently disclose, on the cover pages of periodic reports filed pursuant to Sections 13 or 15(d), any required portion omitted from those reports. It is believed that this requirement will assist the investing public and the Commission in the review of Exchange Act reports.

Corporate Accountability; Management Background and Remuneration – Responding to numerous events that raised questions about the adequacy of corporate accountability

mechanisms, the Commission established a task force in 1977 to undertake a broad reexamination of its rules related to shareholders communications, shareholder participation in the corporate electoral process and corporate governance generally.[67] The Commission determined to address in stages, the complex issues raised during the ensuing public hearings. In December 1978, the Commission adopted final rule, form and schedule amendments designed to provide shareholders with additional information about the matters on which their vote is solicited.[68] Generally, these amendments require disclosure of: (1) The existence and functioning of audit, nominating and compensation committees; (2) attendance of directors at board and committee meetings; (3) certain economic and personal relationships between directors or nominees and an issuer or its management; and (4) resignations of directors.

On August 13, 1979, the Commission proposed a second set of rules related to corporate accountability.[69] The proposals would require that shareholders be provided with a proxy card which: (1) Indicates whether the proxy is solicited by the board of directors; (2) provides a means to vote for director nominees individually; and (3) removes discretionary authority to vote unmarked proxies. The proposed amendments also would require disclosure of prior year election results in certain circumstances and would expand the types of communications exempt from the proxy rules. (On November 20, 1979, the Commission adopted a version of these rules modified to reflect certain comments received.)[70]

The Task Force on Corporate Accountability was, at the close of the fiscal year, engaged in preparing a comprehensive report on the corporate governance proceeding. The staff monitored governance disclosure appearing in the proxy statements of 1,200 representative issuers during the 1979 proxy season. In addition to analyzing the results of the disclosure survey, the report is expected to address such issues as the functions of the board of directors and its committees; solicitations of beneficial owners of stock held in street and nominee name; disclosure of corporate activities having both economic and social impacts; and the respective roles of private sector, institutional shareholders, self-regulatory organizations, the

states, the Commission and Congress in corporate accountability. After review of the staff report, the Commission will consider what further action, if any, is appropriate and will determine whether to publish additional rulemaking proposals or to recommend or support new legislation affecting corporate accountability.

In a release dated December 4, 1978, the Commission amended certain disclosure forms and regulations to standardize and improve the disclosure requirements relating to management remuneration.[71] The Amendments revised the management remuneration disclosure provisions in certain registration statements, periodic reports and proxy and information statements filed with the Commission to require tabular and other forms of disclosures as to all remuneration received from the corporation and its subsidiaries for services during the latest fiscal year by certain specified directors, executive officers and officers. Subsequent to the adoption of these requirements, the Commission authorized the Division of Corporation Finance (the Division) to issue its interpretive views regarding certain aspects of the amendments in order to give guidance to registrants.[72]

Monitoring of Existing Guidelines – As a means of accomplishing its stated disclosure program goals, the staff of the Division has undertaken a comprehensive revisitation and review of the disclosure requirements of the Securities Act and Exchange Act. On June 25, 1979, the Commission issued, for public comment, comprehensive proposed staff guidelines for the disclosure in registration statements and reports by electric and gas utility companies.[73] It is anticipated that these guidelines will improve the usefulness to investors of the various documents involved by specifying the types of data which such documents should disclose. It is also believed that the guidelines will benefit companies by increasing the uniformity of disclosure within the industry and eliminating disclosure requirements which are not meaningful to that industry. The comment period closed on September 24, 1979, and the staff began analyzing the comments received.

In August of 1979, the Commission issued a release requesting comments on the quality and desirability of the disclosure made

under the existing guidelines for "Statistical Disclosure by Bank Holding Companies."[74] These particular guidelines have been in operation since 1976. The request is part of the Commission's effort to monitor the effect and value of its disclosure rules and guides with a view to amending or rescinding those rules or guides which do not yield the expected benefits.

On September 6, 1979, the Commission requested comments on the operation and efficacy of certain of its recently adopted proxy statement disclosure requirements as well as certain other disclosure requirements relating to the structure, functioning, and composition of boards of directors.[75]

On September 27, 1979, the Commission published an interpretive release[76] focusing attention on existing requirements under the Securities Act and the Exchange Act concerning environmental disclosure to assist registrants in complying with those requirements and to alert them that the Commission will continue, in appropriate cases, to take enforcement action in instances of non-compliance. The release, in particular, addressed these issues: (1) the need to disclose total estimated expenditures for environmental compliance beyond two years in the future; (2) the obligation to disclose particular types of environmental proceedings; and (3) the circumstances under which companies must disclose their policies or approaches concerning environmental compliance. The Commission reviewed its policies with respect to environmental disclosure in an administrative proceeding" (which is discussed in the "Enforcement" section of this report).

Small Business

While it should be recognized that many of the problems which face small business today result from factors rooted in the broad economic environment rather than the Federal securities laws, the Commission is aware that the rather costly and complicated process of distributing securities in compliance with these laws is felt by some to impede unnecessarily capital formation by small businesses. The Commission has vigorously addressed itself to these problems by

focusing primarily on its existing rules and regulations and on the general problem areas under those rules which have been of the greatest interest to small businesses.

During April and May of 1978, the Commission held public hearings concerning the effects of its rules and regulations on the ability of small businesses to raise capital and the impact on small businesses of the disclosure requirements under the Securities Act. The Commission subsequently adopted revisions to its rules during fiscal 1978 and has continued to implement the policy of easing the regulatory burden on small businesses, consistent with the protection of investors, during fiscal 1979.

In June 1979, the Office of Small Business Policy was established within the Division. The Office: (a) serves as the focal point of the Commission's small business rulemaking initiatives; (b) reviews and comments upon the impact of rule proposals on small businesses; and (c) acts as liaison with Congressional committees, government agencies and other groups concerned with small business. The Office is responsible for monitoring the quality of disclosure included in offerings registered on Form S-18, which is described below. Since the Form was adopted on an experimental basis, the Office will make recommendations as to the continued use of or appropriate amendments to the Form.

The Commission has also adopted certain revisions to Rule 144 and Regulation A. On March 5, 1979, Rule 144 was amended to allow non-affiliates to disregard the Rule's volume restrictions under certain circumstances.[78] To qualify, the seller must have been a non-affiliate for three months and must have held the securities: (a) for three years if they are listed on a national securities exchange or quoted on the NASDAQ, or (b) for four years if the securities are not so listed or quoted and the issuer files reports pursuant to the Exchange Act. On June 1, 1979, the Commission adopted amendments which permit the use of a pre-effective selling document in Regulation A offerings, provided that the securities are sold by underwriter^) who are broker-dealers registered under the Exchange Act.[79]

On March 29, 1979, the Commission adopted Form S-18 and related amendments concerning simplified registration and reporting requirements for small issuers.[80] The Form is available to certain domestic or Canadian corporate issuers for offerings of up to $5 million, of which up to $1.5 million may be sales by existing security holders. The Form calls for narrative disclosure somewhat less extensive than that presently required by Form S-1 and audited financial statements prepared in accordance with generally accepted accounting principles rather than in accordance with Regulation S-X. A corresponding amendment was also adopted which allows issuers to include the narrative and financial disclosure format of the Form S-18 in its initial Form 10-K report.[81] Issuers also have the option of filing the registration statement at the appropriate regional office or at the Headquarters Office.

On September 11, 1979, the Commission proposed Rule 242 which expands the availability of Section 3(b) of the Securities Act to allow issuers to sell up to $2 million worth of securities, subject to provisions of integration delineated in the Rule, without registration or compliance with the more burdensome requirements found in other exemptions from registration.[82] The two major conceptual changes embodied in the Rule are, first, the unregistered sale of securities to an unlimited number of institutional investors with no mandated information requirements (relying on the ability of such persons to obtain material information from the issuer) and, second, the unregistered sale of securities to a limited number of individuals (35) with no sophistication test which must be met, but with an information requirement similar to that found in Form S-18. (On January 10, 1980, the Commission adopted Rule 242.)

(On October 10, 1979, the Commission authorized the issuance of a release indicating that it will not take enforcement action against issuers utilizing Form S-18 to offer $ 1,500,000 or less of debt securities for public sale pursuant to the Securities Act without filing and qualifying the trust indenture under the Trust Indenture Act of 1939. The proposed no-action position would be taken when it appears that such compliance would be inconsistent with both the Commission's ongoing effort to facilitate small businesses in the

capital formation process and the Commission's view that qualification is not required for Regulation A offerings of debt securities.)[83]

Long Range Studies – Policy research by the Commission's Directorate of Economic and Policy Research regarding the ability of small firms to raise capital increased substantially in 1979. Phase I of the Experimental Technology Incentive Program (ETIP) was completed in conjunction with the U.S. Department of Commerce. In this initial effort several policy questions regarding the capital markets confronting small, high technology corporations were addressed. Phase II, now in progress, implements this system and expands the scope beyond the capital raising process to include accounting disclosure, tender offers and other policy concerns relevant to small, innovative enterprises. This effort will be supplemented in fiscal year 1980 with an examination also conducted by the Directorate of Economic and Policy Research, of the role regional brokerage firms play in raising capital for issuers through initial public offerings.

Tender Offer Proposal

In February 1979, the Commission withdrew certain proposed rules with respect to tender offers which had been published in 1976, and published for comment a new proposal and a related schedule.[84] This action was part of the Commission's ongoing program to establish a comprehensive regulatory framework with respect to tender offers.

The proposal would require Tender Offer Statements on Schedule 14D-1 to be filed by the bidder with the Commission, and sent to certain interested persons, predicated on the date of commencement of a tender offer. An initial filing with the Commission prior to the date the tender offer is first published, sent or given to security holders would not be required. Rather than establish a specific time for such filings, the proposal generally would permit a filing to be made as soon as practicable on the date of commencement or, with respect to amendments, on the date the material change or additional tender offer material is first published, sent or given to security holders. This filing standard is designed to create an efficient system in conformity

with the Williams Act which will not unduly burden bidders. In addition, the proposal, which would provide the prompt communication of information regarding tender offers to trading markets, is intended to assist national securities exchanges and the National Association of Securities Dealers, in carrying out their self-regulatory responsibilities under the Federal securities laws.

In addition to establishing comprehensive disclosure requirements applicable to any tender offer subject to Section 14(d) of the Exchange Act, the proposal would also provide a framework for disseminating cash tender offers, and amendments, to security holders. The proposed rules would add content and clarity to the term "published, sent or given" to security holders and are intended to afford a greater number of shareholders the opportunity to receive, consider and evaluate tender offer materials. Three non-mandatory methods of disseminating cash tender offers would be provided: long-form publication; summary publication; and the use of stockholder lists and security position listings. To ensure the efficient operation of the latter method, a procedure would be established under which the bidder's tender offer materials would be sent to security holders either by the bidder who is furnished with stockholder lists, or by the subject company. The choice as to the method used would be the option of the subject company.

To further ensure that investors have an adequate opportunity to consider communications from the bidder, as well as the subject company, in deciding whether to tender to the bidder, sell into the market, or hold part or all of their securities, the Commission also proposed rules that would require all tender offers to remain open for at least 30 business days and for at least ten business days after any increases by the bidder in the offered consideration; provide withdrawal rights for shares deposited by investors during the first 15 business days of an offer and an additional ten business days in the event of a competing offer; and permit bidders to extend pro rata acceptance rights for periods in excess of those required by Section 14(d)(6).

Other proposed rules would require prompt status reports whenever the length of a tender offer is extended and payment for or return of deposited securities as soon as reasonably practicable after the tender offer's termination.

The proposal would also revise the present disclosure requirements relating to subject companies and other persons making a solicitation or recommendation in connection with a tender offer subject to Section 14(d). Thus, proposed Rule 14d-10 and proposed Schedule 14D-10 would replace current Rule 14d-4 and Schedule 14D, respectively. While the proposed rule would require broader disclosure, a narrower class of persons would be subject to its requirements than is currently the case. The limitation on the types of persons who must file a proposed Schedule 14D-10 represents an effort by the Commission to avoid unnecessary regulation in the context of tender offers.

While not applying to a bidder, proposed Rule 14e-2(a) would affirm a duty of disclosure on any other person who trades on non-public material information obtained directly from a bidder or indirectly from a bidder, such as from persons involved or consulted by the bidder in the precommencement planning and preparation stages of a tender offer. The Commission believes that an affirmative duty of disclosure is necessary for the protection of investors because of past abuses, the vital importance of such market information and the extraordinary nature of tender offers.

(On November 20, 1979, the Commission adopted a modified version of these tender offer proposals.)[85]

Going Private and Sale of Asset Transactions

On August 2, 1979, the Commission adopted a new rule and schedule relating to going private transactions by public companies or their affiliates.[86] This was in response to the continued occurrence of going private transactions, the variety of methods employed in such transactions, and the need for disclosure to investors confronted with these transactions. The rule and schedule are intended to augment

and implement the present statutory provisions by prohibiting fraudulent, deceptive and manipulative acts or practices in connection with going private transactions and by prescribing new filing, disclosure and dissemination requirements as a means reasonably designed to prevent such acts and practices.

During the year, several proxy statements involving novel, multi-step sale of asset transactions were filed with the Commission. Typically, the subject transaction involved a cash sale of substantially all of the assets of a public company to another company, often a private company not otherwise engaged in a trade or business. The purchasing company expects to continue the business of the public selling company under the public company's name and hires substantially all of the seller's managers under long-term employment arrangements to manage the business. A significant percentage of the purchase price may be borrowed by the purchaser and, if so, the assets purchased are usually directly or indirectly pledged to secure repayment of the loan. In some cases, the sale of assets, if approved, will be followed by an issuer tender offer by the public company to repurchase its shares for cash out of the proceeds received from the sale. In addition, the public company proposes, as part of the transaction, to amend its certificate of incorporation to change its business to that of an investment company. In view of concerns that were expressed by interested shareholders regarding the adequacy of disclosure; difficulties encountered in the administrative review process; and enforcement actions which had been taken as a result of failure to comply with the disclosure requirements of the Exchange Act, the Commission authorized the Division of Corporation Finance to provide information to the public about current practices and guidance to issuers in fulfilling their disclosure obligations.[87]

Oversight of the Accounting Profession

Report on the Accounting Profession and the Commission's Oversight Role – In July 1979, the Commission submitted to Congress its second Report on the Accounting Profession and the Commission's Oversight Role. This was in accordance with the

Commission’s undertaking, during the June 1977 hearings held on the accounting profession by the Subcommittee on Reports, Accounting and Management of the Senate Committee on Governmental Affairs, to report periodically on the accounting profession's response to the challenges which Congress and others have placed before it and on related Commission initiatives.

The questions raised concerning the accounting profession and its future have centered principally on the profession's capability, absent direct government regulation, to regulate and discipline its members, to assure their independence, and to set auditing and accounting standards. The Report contained the views of the Commission and the staff on the major issues confronting the accounting profession, and analyzed in detail the recent progress made by the profession and the Commission, in dealing with them.

In its July 1979 Report, the Commission concluded that progress has been sufficient to merit continued opportunity for the accounting profession to pursue its efforts at self-regulation. Consequently, the Commission did not recommend, at the time, legislation to supersede or control the regulation of accountants. Further, the Commission continues to believe that it is too early to reach any definite conclusions with respect to possible future regulatory action or legislation. If, for example, the profession's initiatives are not successful, a legislative alternative might well be required. Additionally, the Commission remains unconvinced that comprehensive direct governmental regulation of accounting or accountants would afford the public either increased protection or a more meaningful basis for confidence in the work of public accountants.

During the past year, the Commission has worked with the accounting profession to define the objectives of the self-regulatory program, to assure that the profession's proposed implementation is consistent with those objectives, and to suggest ways in which to achieve the objectives without imposing specific methods. In addition, the Commission has been active during the past year in overseeing the profession's initiatives concerning the independence of auditors

and the accounting and auditing standard-setting processes. In this respect, the Commission has given specific attention to maintaining the momentum for progress in such areas as reporting on internal accounting control, scope of services performed by auditors, and the work of the Financial Accounting Standards Board (FASB) and of the AICPA. The Commission has criticized the profession where necessary, complimented it, when deserved, and in general, has offered its views and insights concerning the self-regulation effort on which the profession has embarked.

With respect to the accounting standard-setting process, the Commission believes that the initiative for establishing and improving accounting standards should remain in the private sector, subject to Commission oversight. However, to retain that prerogative, the FASB must continue its efforts to provide leadership and take necessary action in controversial areas. Also, the members of the accounting profession and the corporate community must encourage the FASB to provide that leadership, support the FASB's decisions and join more actively in the standard-setting process. This next year will be a critical period in assessing the ability of the private sector to demonstrate its ability to move responsibly in addressing the complex, yet essential, issues with which it is confronted.

The process of demonstrating that accountants themselves, rather than government, should (1) retain primary authority to regulate the profession; (2) ensure and instill confidence in professionalism and objectivity; (3) maintain control over the quality of the work of the profession's members and discipline those who fail to adhere to its standards; and (4) formulate appropriate accounting and auditing standards, is one which will demand the profession's and the Commission's continued commitment. The need for leadership regarding these essential issues is greater than ever. Whether it will be effectively provided by the private sector and, if so, by whom, is not yet certain. The Commission stands ready to consider any reasonable alternatives to achieve the essential objectives.

Management Advisory Services (MAS) – The issue of the appropriate scope of services to be provided by independent public

accountants to their audit clients and the effect of such services on their independence has been the subject of much discussion. The problem has been addressed in various fora – by the accounting profession, scholars, the Commission, the Congress, and most recently by the Public Oversight Board (POB) of the SEC Practice Section of the Division of CPA Firms of the AICPA.[88]

In June 1978, the Commission, in Accounting Series Release No. 250 (ASR No. 250), adopted a rule requiring disclosure in proxy statements of services provided by the registrant's principal independent accountants and disclosure of whether the board of directors or its audit or similar committee had approved each service and considered its possible effect on independence. In ASR No. 250, the Commission also indicated that it had not yet determined whether it should propose rules to prohibit public accountants from rendering certain types of services to their publicly-held audit clients. The Commission noted that the SEC Practice Section had asked the POB to consider the matter and stated that the POB should be given an opportunity to present its conclusions before the Commission acted.

On March 9, 1979, the POB submitted its report, "Scope of Services by CPA Firms," to the Executive Committee of the Section. In its report, the POB concluded that prescriptive solutions to the scope of services issue are not necessary at this time.

The Commission reviewed the report of the POB and concluded that it did not adequately sensitize the profession and its clients to the potential effects on the independence of accountants of performance of nonaudit services for audit clients. Accordingly, in June 1979, the Commission issued Accounting Series Release No. 264 (ASR No. 264)[89] in which it stated its views concerning certain factors which accountants should consider in assessing the possible effects upon their independence of the performance of nonaudit services for publicly-held audit clients. In addition, because of the impact which any impairment of the auditor's independence, either in fact or in appearance, could have on the credibility and usefulness of the audit report, the Commission also set forth certain factors which audit committees, boards of directors, and managements should consider

in determining whether to engage their independent accountants to perform nonaudit services.

The possible effect upon audit independence of performing nonaudit services for audit clients is a complex issue. The Commission, in identifying the factors set forth in ASR No. 264, was neither proposing to proscribe particular nonaudit services regardless of the surrounding circumstances, nor seeking to deprecate the very real benefits which may accrue from certain auditor MAS engagements. Rather, the Commission's objective was to re-enforce the sensitivity of interested parties to the considerations involved in judging whether particular nonaudit services should be rendered by a particular registrant's auditor. In each case, the ultimate issue is one of informed professional judgment; no set of factors or criteria can substitute for the careful, case-by-case evaluation which the exercise of that judgment entails.

ASR No. 264 did not end examination of the scope of services issue. The Commission has the responsibility under the securities laws to assure that accountants who practice before it are independent, and will continue its oversight of this area.

The Commission recognizes that the question of independent auditor MAS activity is both difficult and controversial. If future events indicate that further action is necessary, the Commission stands ready to reconsider this issue in order to assure the confidence of investors in the financial reporting of publicly-held companies.

Accounting Standards for Oil and Gas Producers – During the fiscal year the Commission, aided by an Advisory Committee on Oil and Gas Accounting, continued its efforts to implement its August 1978 decision to consider a new method of accounting – reserve recognition accounting (RRA) – for oil and gas producers. The Commission's decision resulted from an extensive public proceeding conducted pursuant to both the Federal securities laws and the Energy Policy and Conservation Act of 1975, which requires that the Commission assure the development and observance of uniform accounting practices for the oil and gas industry.

Because the feasibility of such an accounting method was not assured, the Commission outlined a series of steps for the development and implementation of RRA. As an initial step, the Commission required that registrants disclose certain oil and gas reserve information beginning in fiscal years ending after December 25, 1978. Specifically, on December 19, 1978, the Commission adopted amendments to certain forms and regulations to standardize and improve its disclosure requirements relating to oil and gas reserves and operations.[90] The amendments incorporated into Regulation S-K requirements for disclosure of: (1) The present value of future net revenues from estimated production of proved oil and gas reserves; (2) any favorable or adverse event since the end of the most recent fiscal year which is believed to have caused a significant change in the proved reserves; (3) the average sale price and average production cost per unit of oil and gas produced; and (4) historical information concerning the number of productive and dry wells drilled. The amendments expanded the disclosure of the net quantities of proved reserves from "as of a reasonably current date" to a period of five years, and expanded the types of companies which are required to disclose information concerning the estimated availability of oil and gas from principal sources. An exemption from these disclosure requirements was provided for registrants whose oil and gas activities do not exceed specified criteria.

In September 1979, the Commission adopted a requirement for oil and gas producers to include in their financial statements for fiscal years ending after December 25, 1979, a supplemental summary of oil and gas producing activities prepared on the basis of RRA. The information generated and the experience gained from the presentation of this supplemental summary will provide much of the basis for an eventual decision by the Commission as to whether RRA should be required as the accounting method for the primary financial statements of oil and gas producers.

FASB Conceptual Framework Project – The FASB project to develop a conceptual framework as a basis for addressing emerging accounting problems is the most important financial reporting matter

confronting the profession. The Commission continues to support the efforts of the FASB in this area.

The conceptual framework project continues to be given a high priority by the FASB. The most notable actions during the last year were the issuance of: (1) Statement of Financial Accounting Concepts No. 1 (FAC No. 1), "Objectives of Financial Reporting by Business Enterprises" (November 1978), which establishes the objectives of general purpose external financial reporting by business enterprises; and (2) Statement of Financial Accounting Standards No. 33 (FAS-33), "Financial Reporting and Changing Prices" (September 1979), which requires certain large, publicly-held enterprises to disclose supplementary information about how inflation and changing prices affect their businesses.

The FASB has made important strides in dealing with some of the fundamental issues inherent in the standard-setting process. FAC No. 1, for example, does not limit the scope of financial reporting objectives to financial statements, but rather sets forth those objectives in terms of financial reporting in general. In addition, its focus on users of financial information and their interest in evaluating future performance, including earnings, is a significant and worthwhile step. The Commission is optimistic that a consequence of that focus will be more thought, experimentation, and timely action in achieving improvements in financial reporting.

A major element of the conceptual framework should be to rethink the objectives of the primary financial statements – and, therefore, to rethink what type of information should be included and what information should be presented outside the financial statements. Ideally, the most relevant information would be a projection of cash flows for future periods. However, such information may be highly uncertain and surrogates may have to be used. The decision as to what that relevant information is and whether it should be included in the primary financial statements will be influenced by its measurability. The August 9, 1979 exposure draft of the FASB on qualitative characteristics, "Qualitative Characteristics: Criteria for Selecting and Evaluating Financial Accounting and Reporting

Policies," addresses this is sue. The factors involved in the tradeoff between reliability and relevance are the key to developing guidelines for the type of information that should be included in financial statements. Further clarification of this issue is necessary before display issues, such as the reporting of earnings, can finally be resolved. Additionally, the development of the recognition criteria phase of the conceptual framework project will be critical to the FASB in its search for a definition of "earnings." It is expected that the FASB will give appropriate attention and priority to these important issues.

The current status of financial reporting of oil and gas producing companies reflects the nature of these issues. The Commission's efforts to develop a more useful method of accounting would benefit from the existence of a conceptual framework. It should be recognized that in developing the concept of reserve recognition accounting, the Commission, will, of necessity, have to deal with issues relating to the conceptual framework if they have not, by then, been resolved.

Accounting For the Effects of Changing Prices – The Commission believes that the FASB's requirement that large, publicly-held enterprises disclose certain effects of general inflation and of price changes in specific goods and services is a positive development in providing useful information. Accounting for the effects of inflation and changing prices is one of the most important issues facing the FASB, the profession, the business community and the general public. Conflicting reports of record profits on the one hand and inadequate earnings to maintain and expand capacity on the other, serve only to confuse the issue. Further, they raise questions about the integrity of financial reporting. The basic question in a period of inflation and changing prices is how best to report the effects of all economic events, and not only the effects of transactions with outside parties. If the objective is to measure only the general impact of inflation on business entities, then a general purchasing power or constant dollar approach might suffice. However, that approach may not, and often does not, adequately portray the specific effects of price changes on companies or industries. Therefore, it does not adequately assist investors in assessing or projecting future cash flows or dividend

paying capacity – important objectives of financial reporting as set forth in FAC No. 1. The Commission remains fully committed to ensuring that users receive adequate information about the impact of changing prices on corporate earnings and assets.

The Commission recognizes that the effectiveness of the FASB's new standard will depend, in large part, on the efforts of the accounting profession and the corporate community in applying the standard, and evaluating and providing additional disclosures which may help users assess the impact of changing prices on particular business entities and industries. With respect thereto, the new standard should be viewed as a requirement for the minimum information to be presented to investors – an area where the corporate community must make a positive contribution to the standard setting process by volunteering additional information necessary to make the reporting more useful and meaningful in the particular corporate circumstances.

Last year, the Commission determined to delay reexamination and expansion of its replacement cost rule, adopted in Accounting Series Release No. 190, so as not to conflict with the FASB's consideration of these issues. Based on its evaluation of the FASB statement, the Commission staff in tends to recommend that the Commission take action to delete the requirement for reporting replacement cost information once the disclosure requirements of the FASB statement are fully effective. (On October 24, 1979, the Commission adopted the staff's recommendation and determined to delete the disclosure required by ASR 190 once the requirements of FAS 33 become fully effective.)

Reporting on Internal Accounting Control – Since the disclosure in the 1970's of widespread questionable or illegal corporate payments and enactment of the Foreign Corrupt Practices Act of 1977, there has been increasing attention to, and interest in, the effectiveness of internal accounting controls. The accounting profession, both institutionally through the AICPA's Special Advisory Committee on Internal Accounting Control and individually by many accounting firms, has responded to the need for guidance in evaluating systems

of internal accounting control, and the AICPA's Auditing Standards Board is developing standards for public reporting on internal accounting control.

In April 1979, the Commission proposed for comment rules which would require inclusion of a statement by management on internal accounting control in annual reports on Form 10-K filed with the Commission under the Exchange Act, and in annual reports to security holders furnished pursuant to the proxy rules. The rules, if adopted, would also require that such statement of management be examined and reported on by an independent public accountant. The Commission believes that information regarding the effectiveness of an issuer's system of internal accounting control may be necessary to enable investors to better evaluate management's performance of its stewardship responsibilities and the reliability of interim financial statements and other unaudited financial information generated from the accounting system.

At the close of the fiscal year, the Commission was reviewing the large number of comments received on the proposed rules.

Unaudited Interim Financial Information – Since the issuance of Statement of Auditing Standards No. 24 (SAS ho. 24) by the Auditing Standards Board of The American Institute of Certified Public Accountants (AICPA) in March 1979, several reports by independent accountants on interim unaudited financial information have been included in Securities Act filings on Form S-16 or S-14. Such filings have raised a question as to whether accountants could be liable under Section 11(a) of the Securities Act (which imposes liability on every accountant "who has with his consent been named as having prepared . . . any report") in such circumstances. On September 20, 1979, the Commission proposed for comment two alternative rules[91] either of which, if adopted, would have the effect of excluding accountants issuing such reports from Section 11(a) liability. In encouraging reviews by auditors of interim financial information, the Commission has noted that "the involvement of independent accounts will add the expertise of professional accountants with wide experience in reporting problems. . . . This should improve individual

company reporting and direct greater professional attention to the general problems of interim reporting."[92] (On December 28, 1979, the Commission adopted a rule having the effect of excluding accountants issuing SAS No. 24 reports from Section 11(a) liability.)

Investment Companies and Advisors

The Investment Company Act Study

The Investment Company Act special study group which was established at the end of the last fiscal year by the Division of Investment Management (the Division), continued its comprehensive review of the Investment Company Act of 1940 and the rules, regulations and administrative practices under it with the aim of simplifying, to the extent practicable, the regulation of investment companies, especially by eliminating unreasonably burdensome regulations. The guiding principal of this effort is that whenever possible, and subject to safeguards necessary for the protection of investors, investment companies and their managers should have responsibility for management decisions. Accordingly, the Investment Company Act Study (the Study) has sought to lessen the instances in which the staff of the Commission need participate in the decision-making process by (1) replacing administrative review of proposed investment company activities with rules establishing general criteria under which the activities are permissible; and (2) refining the Investment Company Act's sometimes sweeping statutory prohibitions so as to permit activity not originally contemplated as being within a provision's technical scope or underlying purpose.

The linchpin of the program is enhancement of the authority and responsibility of investment company directors, particularly disinterested directors, as primary overseers of management decisions. This greater reliance on directors, in many instances, permits the withdrawal of the staff as an active participant in certain management decisions while enabling the Commission to preserve, through its compliance and enforcement program an active oversight capability.

Consistent with the goal of greater director responsibility and reduced staff participation in management decisions, the Commission, during

the fiscal year, adopted several rules which permit certain transactions between an investment company and its affiliated person with regard to: (1) joint purchase of liability insurance policies;[93] (2) the receipt of cash or securities pursuant to a portfolio company's plan of reorganization;[94] (3) the purchase of securities from an affiliated underwriting syndicate;[95] (4) certain purchase, sale or lending transactions between affiliated parties;[96] and (5) the receipt of stock exchange commissions by affiliated brokers.[97] During that period, the Commission also adopted rules (1) providing unit investment trusts with startup exemptions from the Investment Company Act's requirements regarding minimum net worth, frequency of capital gains distribution, and forward pricing;[98] and (2) providing increased flexibility in determining when an investment company must price an investment company's redeemable securities.[99] The Commission also proposed rules to ease problems arising when certain contracts for investment advisory or principal underwriting services are terminated.[100]

In addition, for several years the Commission has been considering whether mutual funds (open-end management investment companies) should be permitted to finance distribution of their own shares. The Commission has been reluctant to permit funds to incur distribution expenses because of doubts about (1) whether funds benefit from sales of their shares; (2) whether funds' investment advisers' conflicts of interest could be regulated adequately; and (3) whether it would be fair to existing shareholders for funds to undertake such expenses. After reconsidering the matter in light of the objectives of the Study, the Commission on September 7, 1979, published for comment Rule 12b-1 under the Investment Company Act and certain related rules.[101] If adopted, Rule 12b-1 would permit use of fund assets for distribution if approved by shareholders, the board of directors as a whole, and the disinterested directors. The proposed rule contains conditions intended to increase the independence of the disinterested directors and ensure that the directors permit such a use of fund assets only after considering all pertinent facts and concluding that financial distribution would be likely to benefit the fund and its shareholders.

Disclosure Study

In addition to the foregoing review of the investment company regulatory system, the Division established another study group to undertake a thorough review of investment company disclosure requirements under the Securities Act of 1933 (Securities Act) and the Investment Company Act. The new disclosure study will explore ways to reduce unnecessary burdens on both the industry and the staff which result from present disclosure requirements. Initially, the study group will undertake two major projects: a review of current procedures for processing post-effective amendments to registration statements, which form the bulk of the Division's workload in the disclosure area; and a review of ways to eliminate duplicative reporting requirements in documents transmitted to investment company shareholders.

Investment Company Advertising

During the fiscal year, the Commission took several actions to reduce restrictions applicable to the promotion and sale of investment company shares without diminishing essential investor protections. On March 8, 1979, the Commission withdrew its Statement of Policy on Investment Company Sales Literature.[102] The Statement of Policy, which had been in effect since 1950, was a lengthy document detailing types of representations which would or would not be considered misleading in investment company sales literature. By its specificity, the Statement of Policy tended to induce conformity to prescribed formats. The result may have been to limit innovations unduly and, at the same time, insulate sales literature, which complied mechanically with the Statement of Policy, but was used in a misleading way. At the same time that it withdrew the Statement of Policy, the Commission proposed for comment Rule 156 under the Securities Act, an interpretive rule which briefly and in relatively general terms highlighted what experience has suggested are problem areas in investment company sales literature.[103] (Subsequent to the end of the fiscal year on October 24, 1979, the Commission adopted Rule 156 as revised.[104])

On August 31, 1979, the Commission adopted Rule 434d under the Securities Act[105] which, in effect, permits investment companies to include far more information in mass media advertisements. In the past, investment companies, like other issuers, have been restricted to so-called "tombstone ads" which may contain only relatively limited information about the security and the issuer. However, Rule 434d permits advertisements to include any information which is taken from or which fairly summarizes the full statutory prospectus. The rule should permit investment companies to more effectively communicate important facts, such as performance data, to investors. At the same time, in order to protect investors from misleading statements, Rule 434d advertisements would be subject to some of the liability provisions of the Securities Act applicable to prospectuses.

Institutional Disclosure Program

Beginning on February 14, 1979, more than 650 major institutional investment managers began filing quarterly reports on Form 13F reporting to the Commission on their significant equity holdings pursuant to Rule 13f-1 under Section 13(f) of the Securities Exchange Act of 1934. These reports are transferred to the Commission's Public Reference Room as promptly as reasonably possible after filing, and are normally available to the public within a day to two after they are filed.

The tabulations of the data on Forms 13F, required by Section 13(f)(3), are done by an independent contractor selected through the competitive bidding process. The contractor is required to make a variety of specified tabulations available to the public at reasonable prices within 10 days after receipt of the reports. Since the contractor provides its services without charge to the Commission, the only material costs to the Commission of administrating the program are in staff time. The Commission's various responsibilities are carried out in several different offices and Divisions, making it difficult to be certain how much staff time is devoted to the program, but it is probably on the order of two to four man years.

Because the program is in its first year of operation and the Commission has only limited resources to devote to its operation, the staff and the Commission have, so far, been concerned with resolving technical problems with Form 13F, interpretive questions, and collateral issues such as confidential treatment. No attempt has yet been made to analyze or otherwise use the information which has been filed. After receiving public comment, the Commission decided that it would be unduly burdensome to require reports in machine readable form since managers use a variety of computer systems and some compile reports manually. The independent contractor does prepare a magnetic tape of which may be obtained from either the Commission or the contractor.

Office of Investment Adviser Regulation

The Office was established within the Division of Investment Management in October 1978. The Office was created in recognition of the need to reevaluate the Commission's advisory regulatory program in light of the dramatic growth in the advisory industry and the developments in the kinds of advisory services provided by investment advisers.

The Commission, in January 1979, adopted new investment adviser requirements concerning disclosure, recordkeeping, applications for registration and annual filings.[106] These requirements include: (1) adoption of a new disclosure rule (Brochure Rule) under the Investment Advisers Act of 1940 (Investment Advisers Act) (2) amendment of two rules under the Investment Advisers Act relating to recordkeeping and amendments to the investment adviser registration form; (3) adoption of a new annual report form for investment advisers; (4) revision of certain schedules used by investment advisers and broker-dealers in connection with the respective registration forms for such persons. Concurrently with the adoption of the above rules and forms, the Commission amended a rule and certain forms to require disclosure of brokerage placement practices.[107] A similar disclosure requirement is imposed on investment advisers as part of the Brochure Rule. Taken together, these actions will result in the Commission and the public being

apprised of a great deal of material information about investment advisers which was not previously disclosed in any systematic way.

In other significant rulemakings, .in July 1979, the Commission adopted new requirements under the Investment Advisers Act governing the payment of cash referral fees by investment advisers.[108] The adoption of the new rule makes it unlawful, except under specified circumstances and subject to certain conditions, for an investment adviser to make a cash payment to a person ("solicitor") who directly or indirectly solicits any client for, or refers any client to, an investment adviser. In addition, in June 1979, the Commission issued for public comment a proposed rule under the Investment Advisers Act which would permit certain registered investment advisers to business development companies (as defined in the rule) to be compensated on the basis of a share of net capital gains upon, or net capital appreciation of, the funds, or any portion of the funds of the business development company.[109] Such means of compensation is currently prohibited by the Investment Advisers Act. At the close of the fiscal year, the staff was reconsidering the proposed rule in light of the comments received.

Enforcement Program

The Commission's enforcement program is designed to secure as broad a regulatory impact as possible with the limited resources available. To this end, the Commission relies heavily upon private civil damage actions, Federal securities laws, and upon self regulatory and state and local law enforcement agencies. With respect to those agencies, the Commission devotes substantial efforts towards promoting the effective coordination of enforcement activities. In this manner, the Commission seeks to make maximum effective use of available resources in order to obtain an increased enforcement presence concerning matters within its jurisdiction.

The cases described here reflect the breadth of the Commission's responsibilities and its enforcement responses, and the continued vigor and effectiveness of the enforcement program.

Sanctions and Remedies

The Federal securities laws provide administrative, civil and criminal remedies for violations of those laws. Sanctions in administrative proceedings for those subject to the Commission's regulatory jurisdiction may range from the imposition of a censure to the barring of a securities professional from the profession. The civil court remedy usually available to the Commission is court entry of an injunction barring further violations. The courts often enter orders providing for appropriate additional relief. Criminal sanctions pro vided by the Federal securities laws include fines and imprisonment.

The Federal securities laws are primarily remedial in nature. In recognition of that purpose, in the litigation and settlement of its proceedings the Commission makes every attempt to prevent a recurrence of violative activity and to rectify the result of past violations. The Commission has been particularly successful in securing appropriate relief in injunctive actions and during fiscal year

1979 such relief included, in one case, an order requiring the defendant to return $30 million alleged to have been wrongfully obtained[110]; the appointment of individuals or committees for the purpose of conducting further investigations and reporting publicly the results[111]; the appointment to boards of directors of persons previously unaffiliated with the corporation[112]; restrictions on the future employment of defendants as officers or directors of publicly-held companies[113]; limitations upon the voting of securities[114]; the return to publicly-held corporations of monies improperly obtained by insiders[115]; and the appointment of an independent master to oversee the operations of a corporation[116].

In the majority of its cases, the Commission is able to settle with respondents or defendants on terms which secure the necessary remedial relief. Generally, respondents or defendants who consent to such settlements with the Commission do so without admitting or denying the factual allegations contained in the Commission's complaint or order for proceedings. Thus, unless otherwise noted, in the discussion of cases which, follows, it should be assumed that settlements achieved were upon that basis.

Energy-Related Cases

Due to the tax consequences of investments in certain energy-related products, particularly oil and gas, and the inherent attraction of such investments to investors, the Commission has long had to devote enforcement resources to the control of fraudulent offerings in this field. With the advent of the nation's energy crisis, fraudulent offerings (and the Commission's response to them) have intensified.

Investors in these offerings are often initially contacted as part of a nationwide, long-distance telephone solicitation campaign by salesmen.[117] These campaigns are typified by offerings which fail to comply with the registration requirements of the Securities Act of 1933 (Securities Act) and by the making fraudulent statements to investors to induce them to invest in the offering. Investors are often persuaded to make their investments on the basis of false statements or omissions concerning, among other things, the funding of the entity

in which the investment is made and the use of the investors' funds derived from the offering[118]; the risks associated with the investment[119]; the experience of the issuers' principals[120]; and the use of special accounts in which investors' funds would, purportedly, be placed for protection[121]. One of the major inducements to investors is the purported availability of special tax benefits.[122]

SEC v. Atlas Oil Exploration, Inc.[123] – On July 12, 1979, the Commission filed a civil injunctive action against Atlas Oil Exploration, Inc. (Atlas) and a number of other entities and individuals related to it. The Commission's complaint alleged that, in connection with the offer and sale of approximately $3 million in unregistered fractional undivided working interests in oil and gas leases, the defendants made a number of untrue statements of material facts concerning, among other things: (1) the use of "special escrow" or "trust" accounts for the protection of investors; (2) that investors could recover their investments in 1½–2 years; (3) the experience of the driller of oil wells; (4) that state securities commissioners were receptive to Atlas' "openness and full disclosure"; and (5) that wells drilled would produce on the average of ten barrels of oil a day per well. The complaint also alleged that the defendants omitted to state material facts concerning, among other matters: (1) the entry of cease and desist orders in seven states prohibiting the sale of Atlas securities; (2) the misuse of at least $275,000 of the proceeds of the offerings; (3) that wells in the field where the subject wells were to be drilled were averaging less than one barrel of oil per day per well; (4) that, based upon the experience with production of initial wells drilled by Atlas, investors could not recover their investment in less than eight years; and, (5) that, prior to their involvement with Atlas, the oil well driller had drilled only 12 wells and the experience of the president and controlling shareholder of Atlas was as a salesman with a company that had been enjoined in an action previously brought by the Commission. Additionally, in connection with one of the offerings involved, the complaint alleged the failure to disclose (1) contingencies in securities gas pipeline connections; (2) that the proceeds of the offering would be commingled; and (3) that 22 percent of the total proceeds of the offering would be paid to the president and a vice president of a related corporation.

Several of the issuers named as defendants in the Commission's action consented to the entry of final judgments of permanent injunction. The defendants were enjoined from further violations of the registration and antifraud provisions of the Securities Act and the antifraud provisions of the Securities Exchange Act of 1934 (Exchange Act). Individual defendants consented to the entry of permanent injunctions enjoining them from further violations of the antifraud provisions of the Federal securities laws. Additionally, another corporation and its principal officers and directors were enjoined from further violations of the antifraud provisions of the Federal securities laws and the defendant officers and directors were ordered to file with the court an accounting setting forth the receipts and disbursements of five of the corporation's offerings.

SEC v. Advanced Fuel Systems, Inc.[124] – On December 6, 1978, the Commission filed a complaint against Advanced Fuel Systems, Inc. (AFSI) and an individual. The complaint alleged violations of the registration provisions of the Securities Act and certain of the antifraud provisions of the Federal securities laws based on untrue statements of material fact and omissions to state material facts to investors including: (1) that $1 million had been committed to AFSI for research and development of a fuel system when in fact less than $145,000 was available; (2) information that an "international financier" was backing the corporation with "unlimited funds" when no such backing existed; (3) omitting to disclose to investors the dilution effect of previous stock splits benefiting insiders; (4) failure to follow generally accepted accounting principles when valuing a licensing agreement in financial statements, resulting in an over evaluation of the agreement by about 500 percent; (5) claiming the availability of special tax benefits when not available; (6) representations that the fuel system would yield 100 miles per gallon for automobiles when it was known that, that was not true; (7) omitting to disclose that claims of 66.8 miles per gallon in certain tests were based on unsophisticated, nonscientific, nonverifiable and widely varying test results; (8) representations regarding the cost of the finished product when no facts were available to support any cost prediction; and, (9)

omissions to disclose that funds from the securities sales would be paid to the individual.

The defendants consented to the entry of judgments of permanent injunction enjoining them from further violations of the registration and antifraud provisions of the Federal securities laws. The order of the court also requires the defendants to provide a copy of the ascertainable investors in AFSI.

Questionable Payments

The Foreign Corrupt Practices Act of 1977 [Sections 13(b)(2), 30A and 31(c) of the Exchange Act] (Foreign Corrupt Practices Act) was signed into law in December 1977. That Act prohibits issuers from, among other things, corruptly making payments to officials of foreign governments in order to induce such officials to use either their authority or influence to obtain business for the issuer in that country. Among other things, the Act also requires corporations to maintain systems of internal accounting controls which provide reasonable assurance that certain objectives are met.

Disclosures of unethical and illegal corporate activity resulting in part from the Commission's enforcement activities contributed to Congress' enactment of the Foreign Corrupt Practices Act. During the past year, the Commission's enforcement interests in this area continued and three of the important cases brought are described in the following summaries.

SEC v. Hospital Corporation of America (HCA)[125] – The Commission's complaint in the HCA case alleged violations of the antifraud provisions of the Securities Act and the antifraud, reporting, and proxy provisions of the Exchange Act in connection with disclosures regarding a contract for the management of a hospital in Saudi Arabia. The complaint alleged that, prior to entering into the contract, HCA was informed of facts which indicated that payments to persons of power and influence in Saudi Arabia would have to be made by HCA in connection with the contract. The complaint further alleged that a Liechtenstein entity which received a total of $3.393

million from HCA, purportedly for consulting and other services, was merely a conduit for the improper payments. The Commission's complaint also alleged that HCA made false and misleading statements in registration statements, proxy statements, and other public documents filed with the Commission and in connection with statements made to the staff of the Commission during an informal inquiry.

HCA consented to the entry of a final judgment of permanent injunction from violations of the antifraud provisions of the Securities Act and the anti-fraud, reporting, and proxy provisions of the Exchange Act. In addition to the injunctive relief the terms of the settlement provide that HCA's audit committee, acting with the assistance of its counsel and its independent auditors, will conduct a review of prior investigations by HCA of (1) direct or indirect payments, if any, to agents, employees, or officials of foreign and domestic governments and of foreign domestic customers during a five year period and (2) of the accuracy of HCA's books and records as to the foregoing. HCA's audit committee will prepare a written report containing its findings and recommendations and any action taken by HCA in response to the report will be described in a current report filed with the Commission.

SEC v. Schenley Industries, Inc. (Schenley)[126] – This case involved allegations that Schenley had expended at least $6 million by granting illegal discounts, in the form of cash, credit, free merchandise or other things of value to selected purchasers of Schenley's products in violation of state liquor regulations. As a result, the complaint alleged, Schenley had jeopardized its licenses to do business in the 35 states of the United States in which Schenley operated as a producer, importer and seller of alcoholic beverages. The Commission's complaint alleged violations of the antifraud provisions of the securities laws.

The defendants consented to the entry of final judgments of permanent injunction. As part of its consent, Schenley agreed to, among other things, the appointment of a Special Agent to conduct an investigation of Schenley and its subsidiaries and render a report

to the Court and to the Commission detailing: (1) illegal political contributions made by Schenley and its subsidiaries; (2) illegal foreign payments made by Schenley and its subsidiaries for the purpose of influencing any foreign government or official thereof or evading the laws of a foreign sovereign; (3) illegal kickbacks, rebates, discounts, refunds, allowances , or other expenditures made by Schenley and its subsidiaries to induce the purchase of Schenley products, and the approximate dollar amount expended to the extent that these facts have not been previously disclosed; and (4) pending investigations by state or Federal governmental authorities regulating the liquor industry which may result in the commencement of legal proceedings.

In addition, Rapid-American agreed to file with the Commission a current report: (a) within 30 days after the entry of the final judgments, setting forth ail facts, known as of that date, concerning Schenley's practice of granting illegal discounts to induce and promote the purchase of Schenley products; and (b) upon the filing of the Special Agent's report, setting forth all material facts contained therein.

SEC v. International Systems and Controls Corporation[127] – In this action, the Commission filed a complaint against International Systems and Controls Corporation (ISC) and certain officers and directors seeking injunctive relief, appointment of a receiver and other equitable relief.

The complaint alleged violations of the antifraud, reporting and proxy provisions of the Federal securities laws as well as violations of the accounting provisions of the Foreign Corrupt Practices Act. According to the complaint the corporation made false and misleading disclosures or failed to disclose its commitments to pay a total of $33 million, its payment of approximately $23 million in connection with the securing or solicitation of business in several foreign countries, its overstatement of its assets, earnings and shareholders' equity. The complaint further alleged that the corporation failed to disclose that certain officers were the prime beneficiaries of a deferred compensation plan and that corporate funds were used to purchase,

furnish and maintain a summer residence for the Chairman of the Board of the firm.

The Commission simultaneously filed with the complaint a motion for a preliminary injunction against ISC and for the appointment of a Special Agent of the Court to take custody and control of all assets of ISC; to oversee the business activities of ISC to assure that they are carried out for legitimate purposes of ISC and not for the personal benefit of any control person, officer, director or employee of ISC; to determine whether ISC entered into any transactions involving expenditure of substantial funds or assets which appear not to have been engaged in for legitimate business or are not adequately explained on ISC's books and records; to recover any funds or assets or enforce any liability to ISC; to oversee ISC's filings with the Commission; and to authorize the agent to report his findings to the Court within 60 days.

Government and Municipal Securities

As indicated in last year's annual report,[128] the trading of government and municipal securities has increased significantly in recent years. Due to the continuation of questionable issuing and trading practices in this area, the Commission's enforcement interest has also continued.

In February 1979, the Commission transmitted to Congress its *Final Report In the Matter of Transactions in the Securities of the City of New York,* and simultaneously announced its conclusion of the investigation in that matter.[129] The investigation, one of the largest of most complex in the Commission's history, dealt with events occurring during the period from October 1974 to April 1975 when the City faced a fiscal crisis and issued large amounts of short-term securities. The Commission had previously issued a detailed Staff Report which described the events leading to the City's fiscal crisis.[130]

The Final Report issued in February called for legislative action to solve the deficiencies in the issuance and marketing of municipal securities and concluded that the Commission should devote its

efforts to support such legislative solutions. The Final Report also stated the Commission's conclusion that no enforcement proceedings should be instituted in the matter.

Among the factors cited in the Final Report for the Commission's decision were the issuance of the comprehensive Staff Report[131]; the change in the City's administration since the issuance of the Staff Report; various remedial actions taken by those who were mentioned in the Staff Report, most particularly by the City itself; Congressional and state actions with respect to New York City's financial difficulties, including the Federal legislation enacted in August 1978 which imposes certain financial controls over the City and requires, among other things, that the City's financial statements be audited; and, finally, the Commission's determination that enforcement action would have limited additional remedial value and would require the commitment of substantial additional resources which, in light of the above, could otherwise be used more efficiently in discharging the Commission's responsibilities.

The Final Report focused attention on the area of municipal accounting and financial reporting and stated:

"The Commission believes that legislation designed to standardize the methods used in the preparation of municipal accounts and the form and content of municipalities' financial statements should be accorded the highest legislative authority."[132]

The *University of Houston* case – The Commission continues to note instances of questionable practices in connection with United States Government securities and related securities. In this connection, of particular importance during fiscal year 1979 was the Commission's so-called "University of Houston" case.[133] The case involved a group consisting of an employee of the University who was its government securities trader and various individuals and securities firms. Securities involved in the case were government securities (including so-called Ginnie Mac's) and reverse repurchase agreements (a pledge of securities which takes the form of a sale and buy-back obligation).

The Commission alleged in its complaint that the University's employee channelled securities transactions through the securities firms and individuals who were defendants in the action, to their benefit and to the University's detriment. The complaint also alleged that one of the securities firms involved charged excessive fees to the University and charged commissions to both sides of transactions while purportedly acting as a broker for the University. That firm also allegedly agreed to execute transactions for the University at prices away from the market and to "park" government securities with the University. The complaint alleged that in the event that the market price for securities increased, the securities were to be sold back to the firm at the original price. In addition, the complaint alleged that the firm, acting as a broker or principal in trades with the University, engaged in trades covering approximately $318 million in securities upon which the firm made profits or commissions of approximately $590,000.

The complaint also charged that another firm had defrauded the University by charging excessive fees and by inter-positioning with respect to $35 million in government securities transactions by the University. Over $130,000 in commissions were generated by these transactions.

Finally, the complaint alleged that another firm was needlessly interpositioned with respect to the University's trades in government securities to the financial detriment of the University and that excessive fees were charged to the University in connection with reverse repurchase transactions. These transactions were, allegedly, employed by the University's employee as part of an investment strategy whereby government securities were pledged in connection with cash loans. The loans were used in turn to purchase additional government securities. The firm acted as a broker for the University in trades involving about $1 billion in reverse repurchases and about $73 million in government securities transactions. The case resulted in the issuance of injunctions against the principal defendants as well as a criminal proceeding in which they were found guilty and sentenced to four years in prison.[134]

Industrial Development Revenue Bonds – A persistent concern of the Commission in the area of government securities has been abuses in the offer and sale of industrial development revenue bonds. These securities generally are issued by municipalities to obtain funds to erect industrial facilities which are then leased to private corporations for business use. Principal and interest on the bonds is paid only with revenues of the private corporation.

Industrial revenue bonds, though subject to the antifraud provisions of the Federal securities laws, are exempt from the registration requirements of those laws.

The Commission's *Staff Report On Transactions In the Marine Protein Corporation Industrial Development Revenue Bonds* is illustrative of the types of concerns arising in this area.[135] The staff report details an unusually instructive situation involving a corporation which had sold stock to the public in an offering registered with the Commission and, shortly thereafter, also participated in an offering of industrial revenue bonds which were issued for the purpose of providing funds to construct facilities for the corporation. The staff report discussed disclosures made in the prospectus for the registered stock offering and compared them with disclosures in connection with the industrial development revenue bond offering. The staff report concluded:

"... [T]hat risk factors and other important information relating to the speculative nature of an investment in Marine that were included in the common stock prospectus are absent from the bond 'offering prospectus' and that document contains considerable bullish promotional information that is inappropriate in a prospectus used to sell securities."[136]

Other areas of questionable activities in connection with industrial revenue bonds which were the subject of Commission action this year included alleged situations where bonds were sold prior to issuance, but after collecting the money from purchasers, the promised bonds were not issued to customers and, instead, the

customers' funds were converted to the promoter's use[137]; nearly worthless bonds were sold to investors at 94-98 percent of face value[138]; principal and interest payments were made from proceeds of bond sales to conceal the fact that the private corporation was not a going concern[139]; and misleading quotations were placed in interdealer quotations media[140].

Options, Corporate Takeovers and Tender Offers

During the fiscal year, the Commission brought a number of cases in situations where the investing public was harmed as a result of practices by market professionals and others in connection with trading in options. Additionally, as the Commission noted in last year's annual report[141], the recent increase in the number of corporate takeovers and tender offers has led to an increasing number of Commission enforcement actions in this area. In this connection, the Commission has brought an increasing number of cases alleging insider trading based upon material information regarding corporate takeovers and tender offers.

Options – The Commission's option cases involved allegations that material misstatements and omissions were made to customers concerning, among other things, the risks inherent in option trading strategies[142]; the potential profits and rates of return involved in options trading[143]; and the suitability of trading strategies used for investors[144].

In the Matter of Bear Stearns & Co.[145] – This case is illustrative of the types of trading practices which the Commission uncovered during the course of its investigations this year. In this case, the Commission's Order Instituting Proceedings and Imposing Remedial Sanctions alleged that transactions executed in accounts as to which discretionary authority existed were excessive in size and frequency in light of the financial resources and character of the accounts and that, in connection with options trading, material misstatements were made concerning the existence of margin accounts, the meaning and purpose of margin call notices sent to customers, the significance of the large number of confirmations slips received by customers and

the meaning and purpose of correspondence sent to a customer with regard to activity in the customer's account. Additionally, the Order alleged that transactions in customer accounts were effected which were not authorized by the customers including trading in the options market, trading on a principal basis, and trading in a margin account. Finally, the Order alleged that transactions in customer accounts were effected in unseasoned and speculative securities in disregard of or without inquiry regarding the suitability of the securities to individual customer needs, circumstances or objectives.

SEC v. Santangelo & Co.,[146] – This was another significant action by the Commission in the options area during this year. The case involved fictitious reports of options transactions on the hew York Stock Exchange (NYSE) and the American Stock Exchange (Amex). Specifically, the Commission's complaint alleged that in varying periods in 1974, 1975, and 1976, hundreds of transactions in options were printed on the stock and options tape of the Amex when in fact no transactions had occurred. Additionally, the complaint alleged that during 1976 transactions in stocks which should have been reported on the tape of the NYSE as single transactions were reported as several transactions. The complaint further alleged that various of the defendants, either as specialists on the subject exchanges or otherwise, either caused a substantial number of such erroneous reports or had reason to know that those reports were being printed and failed to take reasonable and appropriate steps to prevent such reports from being made.

Tender Offers – The Commission's actions in the area of tender offers during the past year involved situations where the Commission alleged that materially false and misleading statements were made to investors concerning, among other matters, the purposes of the tender offer[147]; financing arrangements with respect to the tender offer[148], and the intentions of the tender offerer[149].

The defendants, two broker-dealers registered with the Commission and partners of each firm, consented to the entry of judgments of permanent injunction enjoining them from violating the antifraud provision of the Exchange Act.

SEC v. BOC International Limited[150] – This was one of the more significant Commission actions brought in the tender offer area during the past year. In this case, the Commission filed a complaint seeking injunctive relief against BOC International Limited (BOC) a United Kingdom corporation and its wholly-owned subsidiary, BOC Financial Corporation (BOCF), a Delaware corporation. The complaint alleged that the defendants violated the tender offer and reporting provisions of the Exchange Act in connection with BOC's tender offer for shares of Airco Inc. (Airco).

According to the Commission's complaint, BOC and Airco entered into a series of agreements governing potential tender offers by one firm for the securities of the other. Pursuant to these agreements, BOC acquired a 34 percent interest in Airco and subsequently increased that interest to 49 percent. The latter tender offer was oversubscribed. BOC subsequently announced a tender offer for all Airco shares at the same price as the previous offer. Pursuant to their agreement, Airco disapproved the tender offer for the remaining outstanding shares based upon the inadequacy of the price and sued BOC to rescind the offer. BOC withdrew the offer for all outstanding shares but pursuant to a prior agreement purchased an additional 6 percent of Airco. The latter purchases were designed to frustrate any competing offers for Airco and to avoid entering a bidding contest for Airco. Subsequently, Airco announced an agreement in principle for a takeover of Airco by a third company at $50 per share. Shortly after this announcement, BOC and Airco announced a settlement of their action, pursuant to which BOC offered an additional $7 to all those who tendered their shares in the offer that resulted in BOC's obtaining the additional 15 percent of Airco, and agreed to make a $50 offer for all remaining Airco shares.

The Commission, in its complaint, charged that BOC Ltd. violated the antifraud provisions of the securities laws in that the tender offer materials failed to disclose that in obtaining a loan for the second tender offer, BOC sought sufficient funds to acquire additional shares, that BOC's agreement with its investment banker included an additional $1.5 million fee if BOC acquired 100 percent of Airco, and

that Airco's investment banker had formed an opinion that a fair price for Airco shares was $50-$55 per share. The complaint also charged that BOC failed to amend its statement filed with the Commission with respect to its holding of Airco shares on a timely basis and, when it did so, failed to disclose the purpose of its acquisitions and subsequent action.

BOC consented to the entry of an injunction requiring compliance with the tender offer and reporting provisions of the Federal securities laws. BOC also agreed to pay $2.75 million to certain individuals who tendered Airco stock and to keep open the $7 offer to Airco shareholders who tendered their stock,

SEC v. Sun Company, Inc. – In last year's annual report, the Commission noted the Sun case as one of its important actions in the tender offer area.[151] That case involved, among other things, a Commission allegation that the acquisition of approximately 34 percent of the outstanding common stock of a publicly-held corporation by means of an offer to certain institutional investors which was not made available to the general public nevertheless constituted a tender offer. On July 9, 1979 the United States District Court for the Southern District of New York rendered an opinion which found that, indeed, that acquisition constituted a tender offer and was, accordingly, made in violation of the tender offer provisions of the Exchange Act.[152]

Insider Trading – Among the Commission's actions in the insider trading area during the last year, one of the more important was *In the Matter of Oppenheimer & Co.*[153] The Commission instituted proceedings in this matter to determine whether Oppenheimer & Co., Inc. (Oppenheimer), a registered broker-dealer, failed to supervise Ira J. Hechler (Hechler), a person subject to its supervision with a view to preventing violations of the antifraud provisions of the Exchange Act.

According to the Commission's Order Instituting Proceedings Hechler was retained by Oppenheimer as a consultant for special acquisitions. Hechler occupied offices at Oppenheimer and utilized their facilities. Transactions proposed and the companies

recommended by Hechler as potential subjects for special acquisitions were reviewed by senior principals of Oppenheimer.

In his capacity as a consultant for special acquisitions, Hechler researched and investigated publicly-held companies for sale of assets transactions and often engaged in the negotiations involved in such transactions. As result of these activities, Hechler obtained material non-public information concerning the companies involved in such transactions as well as the likelihood that the sale of assets transactions would be consummated. Specifically, Hechler knew that if the transactions were consummated a company involved in the transaction would make a tender offer at substantial premiums above then prevailing market prices.

The Commission determined that Oppenheimer failed to reasonably supervise Hechler and thereby prevent violations of the antifraud provisions. Pursuant to an offer of settlement, Oppenheimer was censured and agreed to comply with certain undertakings. The undertakings included among other things, (1) that Oppenheimer would obtain a written agreement from Hechler that neither he nor members of his immediate household will maintain any accounts with any other broker-dealer, (2) that as long as he is associated with Oppenheimer neither he nor his immediate family will trade in the stock of any company he is considering as a potential participant in a sale of assets transaction without obtaining prior written approval which Oppenheimer will not give unless the trading is not based upon non-public information, and (3) that as- long as Hechler is associated with Oppenheimer he will make all disclosures and reports that Oppenheimer's employees are required to make in accordance with Oppenheimer's regular compliance procedures.

Other Significant Enforcement Matters

In the Matter of United States Steel Corporation[144] – The Commission instituted proceedings in this matter to determine whether certain of the filings of United States Steel Corporation (USSC) made with the Commission were deficient with respect to USSC's policy concerning environmental regulation, its capital expenditure for compliance with

environmental control and its involvement in legal proceedings arising from its compliance with environmental regulation.

In 1971, in recognition that environmental laws could have a material economic impact on corporations subject to such environmental regulation, the Commission issued a release informing registrants that disclosure of material environmental information including environmental litigation and the capital expenditure, earning powers, and business charge efforts in connection with compliance with environmental laws was required by Commission rules.[155] In 1973, the Commission adopted specific environmental rules which required disclosure of material effects that compliance with environmental regulation might have upon *a* Registrant's economic position and disclosure of any administrative or judicial proceedings known to be contemplated by governmental authorities concerning violations of environmental regulations.[156] Subsequently, the Commission adopted a rule requiring registrants to disclose certain material estimated capital expenditures for environmental control facilities.[157]

According to the Commission's Order Instituting Proceedings, USSC was aware that compliance with environmental regulations would require substantial expenditures. USSC prepared its own estimates as to the cost of compliance as regulations were proposed and adopted. USSC, in its filings, set forth amounts spent or authorized for certain periods without disclosing that it had developed estimates of costs for additional years, which costs would involve material capital expenditures. USSC disclosed pending judicial proceedings, but failed to disclose existing administrative proceedings. Additionally, USSC stated in its filings that it intended to resolve its environmental problems. In fact, USSC pursued an environmental policy of actively resisting environmental requirements which it maintained were unreasonable. While the Commission's rules do not require a disclosure of a general corporate policy with respect to environmental regulation, if such a disclosure is made it must be accurate and the disclosing corporation must make any additional disclosures necessary to render the voluntary disclosure not misleading. Also, if a corporation has a policy toward compliance with environmental regulations which is reasonably likely to result in substantial potential

fines or penalties, or other significant effects on the corporation, it may be necessary for the registrant to disclose the magnitude of such fines, penalties and other material offsets in order to prevent from being misleading with regard to required disclosures concerning such matters as descriptions or disclosures relating to the corporation's business, financial statements, capital expenditures for environmental compliance or legal proceedings. USSC did not make such additional, necessary disclosures.

The Commission determined that USSC's reports filed with the Commission for the years and interim periods 1973 to 1977 failed to comply with the disclosure requirements of Section 13 of the Act and the applicable rules relating to disclosures of environmental matters. USSC submitted an Offer of Settlement which the Commission determined to accept. The Commission's Order required USSC to comply with the undertakings set forth in its offer of settlement which include, among other things, that USSC will, by various means, provide notice to its stockholders of the existence of these proceedings and the Commission's Order, that USSC will amend its past filing with the Commission concerning environmental matters and that USSC will retain a consultant to conduct a study for the purpose of estimating potential costs to USSC of complying with environmental regulations.

SEC v. Rapid American Corporation[158] – The Commission filed a civil injunctive action against Rapid American Corporation (Rapid), its subsidiary McCrory Corporation (McCrory), Kenton Corporation (Kenton) and Meshulam Riklis (Riklis), Rapid's Chairman of the Board, alleging violations of the reporting provisions of the Federal securities laws. The complaint also alleges that Rapid, McCrory and Riklis violated the proxy provisions and that Riklis and Kenton violated the beneficial ownership reporting provisions of the Federal securities laws.

According to the Commission's complaint, Rapid, McCrory and Kenton failed to disclose that they entered into agreements with and paid fees to persons who were either personal creditors of Riklis or persons who had a personal business relationship with Riklis. The

agreements and transactions in question were allegedly either negotiated or approved by Riklis at a time when he was in serious financial difficulty. The complaint also alleged that Riklis was in a conflict of interest position in negotiating and approving transactions with persons with whom he had personal business dealings and that these conflicts were not disclosed to the Boards of Directors of Rapid, McCrory, Kenton, security holders or the public.

The defendants consented to the entry of final judgments of permanent injunction enjoining them from violating the provisions of the Federal securities laws charged in the complaint. In addition to consenting to the entry of an injunction, Rapid agreed to appoint four persons who had no previous affiliation with Rapid to its board of directors, and to form and maintain for five years a Transaction Review Committee, composed of the four new directors, to review transactions between Rapid and its officers, directors and control persons. McCrory agreed to abide by the undertakings of Rapid, while Kenton agreed to adopt similar policies. Riklis agreed to abide by the undertakings instituted by Rapid, McCrory and Kenton.

SEC v. The Fundpack, Inc.[159] – In this case the Commission sought injunctive relief against a mutual fund complex, the investment adviser to the funds and its broker-dealer subsidiaries, and certain directors, officers and employees of these entities. The Commission's complaint alleged violations of the antifraud, registration, reporting, proxy and fiduciary obligation provisions of the Federal securities laws.

The complaint alleged that the investment adviser, in disregard of the interests of the mutual funds and their shareholders and in order to increase profits to the adviser, promoted an investment arrangement known as switching. The switching program permitted and encouraged the fund’s shareholders to transfer their investments among the funds immediately upon the placing of a telephone order. This program resulted in frequent fluctuations in the assets of the funds and, accordingly, an extremely high portfolio turnover with an attendant increase in brokerage expenses most of which were rebated to the investment adviser.

The complaint also alleged that each of the directors of the Fundpack, Inc. (Fundpack), in breach of his fiduciary duty involving personal misconduct, favored the management of the funds by acquiescing in this conduct and by renewing the investment advisory contract. The complaint further alleged that the directors failed to conduct inquiries and consider information necessary for them to evaluate the switching program and the self-dealing transactions by the investment adviser.

The mutual funds consented to the entry of an order directing the appointment of independent directors and special counsel. This order concludes the Commission's action against the funds; the action against other corporate and individual defendants continues.

Pursuant to the Final Order, the Funds are required to appoint and thereafter nominate and recommend for election to their respective boards of directors four individuals satisfactory to the Commission, and the funds must maintain, until at least one year after the next meeting of their shareholders, boards of directors not less than 80 percent of whose members are satisfactory to the Commission. The newly constituted boards are required to call meetings of the Funds' shareholders within six months, at which time they must recommend to shareholders the election of the required proportion of directors satisfactory to the Commission and recommend arrangements for the future management and disposition of the funds.

In addition, the Final Order requires that the Funds retain a Special Counsel to advise them until after the aforementioned shareholders' meetings. The Special Counsel must among other things, (1) supervise the filing and dissemination of registration statements, prospectuses, annual and periodic reports and sales literature, receipts and disbursements by the Funds, portfolio transactions and proxy solicitations; (2) consult with and report to the Commission and the Court; and (3) advise the Funds' boards in their consideration of arrangements for the future management and disposition of the Funds. After the performance of all of his duties, the Special Counsel must submit a final report to the Commission and the Court.

The Final Order also requires that within 20 days, the Funds must report to shareholders concerning the Commission's Complaint, the history of this litigation, and the actions taken and to be taken pursuant to the Final Order and any other consents, undertakings, agreements or orders entered in the action.

SEC v. Starr Broadcasting Group, Inc.[160] – In February 1979, the Commission announced the filing of a complaint in the United States District of Columbia against The Starr Broadcasting Group, Inc. (SBG); William F. Buckley Jr. (Buckley), formerly Chairman of the Board of SBG; Peter H. Starr (Peter Starr), formerly President and a director of SBG; Michael F. Starr (Michael Starr), formerly Vice-President and a director of SBG; Gordon M. Ryan (Ryan), formerly General Counsel and a director of SBG; Glenn E. Burrus (Burrus), formerly a director of SBG; Maurice L. McGill (McGill), formerly a director of SBG; Mack H. Hannah, Jr. (Hannah), a director of SBG; and Columbia Union National Bank & Trust Company (Columbia Union), one of SBG's lenders.

The Commission's complaint alleged that certain of SBG's officers directors, and others engaged in a five-year course of business ultimately resulting in the purchase, by SBG of seventeen theatre properties (the Sitco transaction) from Sitco, Ltd. (a partnership whose members were Buckley, Peter Starr, Michael Starr and Ryan) for the purpose of extricating Buckley, Peter Starr, Michael Starr and Ryan from a financial situation which would have resulted in their personal bankruptcy; that various filings of SBG failed to disclose or contained misleading disclosures with respect to the Sitco transaction; that SBG's outside directors, after acting on behalf of SBG in approving the Sitco transaction, failed to insure the accuracy of SBG's disclosures relating to this transaction; that Burrus, as Columbia Union's senior loan officer responsible for loans to both SBG and Sitco, Ltd., was acting in a manner which benefited Columbia Union, to the detriment of SBG, by approving the Sitco transaction, and also failed to insure accurate disclosure of these matters.

Pursuant to the consents of the defendants, the Court enjoined SBG from further violations of the reporting, proxy, ownership reporting and margin requirements provisions of the Federal securities laws. Buckley, Michael Starr, Peter Starr, Ryan, and Burrus, were enjoined from violating the antifraud, reporting, proxy, ownership reporting, and margin requirement provisions of the Federal securities laws. Columbia Union was enjoined from violations of the reporting provisions of the Federal securities laws. Smith, McGill, Francis and Hannah were enjoined from further violations of the reporting, ownership reporting and margin requirement provisions of the Federal securities laws.

In addition to the entry of the injunctions, certain other equitable relief was ordered by the Court or undertaken by the defendants, including an order to make disgorgement and an order compelling Buckley, Michael Starr, Ryan and Burrus to comply with their undertakings that none will seek employment as an officer or director of a publicly-traded corporation responsible for filings with the Commission for a period of years.

SEC v. American Financial Corporation[161] – The Commission filed a complaint seeking injunctive relief and other equitable relief against American Financial Corporation (AFC), Carl H. Lindner (Lindner), President, Chairman of the Board and controlling shareholder of AFC, Charles H. Keating Jr. (Keating) former Executive Vice-President and Director of AFC, and Donald P. Klekamp (Klekamp) a former director of a subsidiary of AFC. The complaint alleged that the defendants violated the antifraud, proxy and reporting provisions of the Federal securities laws.

According to the Commission's complaint, Lindner and Keating caused, authorized or permitted a bank subsidiary of AFC to extend substantial loans on preferential terms to officers and directors of AFC and to other persons associated with AFC, its subsidiaries, Lindner or Keating. The complaint further alleged that as the financial condition of the borrowers deteriorated from 1973 through 1976 demands on the prior loans were not made and new loans were

extended enabling the borrowers to pay interest on the prior loans and service loans from other.

The complaint also alleged that Lindner and Keating caused a subsidiary of AFC to advance funds to Klekamp for the purchase of AFC stock on the open market. The subsidiary failed to disclose these loans in a registration statement filed with the Commission. While the subsidiary did disclose the extension of such loans in its annual report filed with the Commission, it failed to disclose relevant facts and circumstances concerning the loans. AFC and its subsidiary also made false reports in filings with the Commission concerning loans to Klekamp. The complaint alleged numerous other violations concerning the extension of loans by AFC subsidiaries.

The defendants consented to the entry of final judgments of permanent injunction enjoining them from further violations of the antifraud, reporting and proxy violations. Additionally, the order consented to by the defendants required AFC to establish and maintain an audit committee of its board of directors consisting of at least two directors not having any previous business affiliations with AFC or its subsidiaries and to amend and correct its prior filings with the Commission with respect to matters alleged in the complaint.

Programmatic Litigation and Legal Work

The Commission, through its Office of the General Counsel, participates as a party and as *amicus* in a substantial amount of litigation in addition to its enforcement actions. The results in these suits often affect existing interpretations of the Federal securities laws and/or the scope of the Commission's authority. The Office of the General Counsel is also involved in important non-litigatory work. The following is a summary of some of the important actions which were litigated in the past year, and the status of other projects of significance to the Commission and the public.

Significant Court Actions

Touche Ross & Co., et al v. SEC – Touche Ross raised questions about the Commission's power to regulate the conduct of accountants and other professionals who practice before it. Rule 2(e) of the Commission's rules of practice, first promulgated over 40 years ago, authorizes the Commission to censure, suspend, or bar from Commission practice, professionals found to have engaged in various unethical or unlawful conduct. The rule reflects the Commission's need to rely heavily on the integrity of accountants and other professionals who prepare and certify the accuracy of corporate filings vital to investors.

Pursuant to Rule 2(e), the Commission had instituted proceedings against Touche Ross and three of its former partners. The order for proceedings alleged that in examining two public companies, the accountants had failed to follow generally accepted accounting standards and had no reasonable basis for their opinions regarding the financial statements of these companies. The respondents filed a district court action attempting to halt the proceedings. They alleged that the Commission was without authority to promulgate Rule 2(e), and had acted "without authority of law" in instituting the proceedings. On a motion from the Commission, the district court dismissed the

Touche Ross action, holding that the plaintiffs had failed to exhaust their administrative remedies.

On appeal, the United States Court of Appeals for the Second Circuit upheld the Commission's power to promulgate Rule 2(e). The Court first held that the traditional exhaustion doctrine did not apply where plaintiffs had challenged the agency's very authority to promulgate the rule. In such cases, judicial review would not be enhanced significantly by allowing the agency to first develop the facts or apply its expertise. And, although the agency could theoretically hold its own rule invalid, such a result was unlikely.

Turning to the merits, the Court held that, the promulgation of Rule 2(e) was valid as a "legitimate, reasonable and direct adjunct to the Commission's explicit statutory power." The Court reasoned that a central purpose of the securities laws was the protection of investors through the requirement that issuing companies disclose fully to the public information material to investment decision-making. The Commission, with its small staff, could not possibly review in detail each company's financial statements; necessarily, then, the Commission had to rely heavily on both legal and accounting professionals to perform their tasks diligently and responsibly. The Court concluded that Rule 2(e) represents an attempt by the Commission to protect the integrity of its most important processes, and is therefore a valid exercise of the Commission's general rulemaking power.

SEC v. Aaron; SEC v. Coven – The *Aaron* and *Coven* cases raised the important issue of whether the Commission must prove *scienter* in injunctive actions brought under the antifraud provisions of the Securities Act of 1933 (Securities Act) and the Securities Exchange Act of 1934 (Exchange Act). In both cases, the United States Court of Appeals for the Second Circuit held that *scienter* need not be proved in such an action.

The Court of Appeals' holding in *Coven* involved proceedings brought under Section 17(a) of the Securities Act. The Court noted that the language of Section 17(a) does not indicate that liability must be

predicated in an intent to manipulate, deceive or defraud, and thus concluded that *scienter* is not an element of a violation of that section. The Court also stated that even negligent conduct is sufficient to impose liability upon an alleged aider and abettor who "should be able to conclude that his act was likely to be used in issuance of the illegal activity. ..." The Supreme Court thereafter declined to review the Court's decision in *Coven.*

In *Aaron,* the Court's holding involved injunctive proceedings under both Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act, and Rule 10b-5 thereunder. Based on its analysis of the language of Section 10(b), the legislative history of the Exchange Act, the relationship between Section 10(b) and the express private remedy provisions of the securities laws, and the effect of *scienter* standards on the overall enforcement scheme contemplated by those statutes, the United States Court of Appeals for the Second Circuit rejected Mr. Aaron's contention that the Supreme Court's decision in *Ernst & Ernst v. Hochfelder,* 425 U.S. 185 (1976) in which it was held that *scienter* is necessary in a private damage action under Section 10(b), compels the same result in a Commission injunctive action. The Court also rejected a *scienter* requirement for Commission injunctive actions brought under Section 17(a), relying on its prior decision in *Coven.* Mr. Aaron subsequently filed a petition for certiorari in the Supreme Court.

The imposition of a *scienter* requirement in all Commission proceedings brought to prevent recurrence of conduct that operates as fraud or deceit on public investors, and the resulting difficulty in providing a defendant's state of mind, would erode significantly the Commission's ability to enforce the Federal securities laws and deprive investors of needed protections. Moreover, the question of whether *scienter* is required in an injunctive proceeding of Section 17(a) and Section 19(b) has been and continues to be the subject of substantial litigation. With respect to Section 10(b), there has been great uncertainty in the courts of appeals and the district courts as to whether *scienter* is an element.

Recognizing these factors, the Commission, in responding to Mr. Aaron's petition for certiorari, has urged the Supreme Court to grant the petition in order to bring certainty to the administration of the Federal securities laws and to conserve the resources now being expended by courts and parties, including the Commission, in litigating these issues. (The petition for certiorari was granted by the Supreme Court on October 15, 1979.)

Burks v. Lasker – The issue raised in *Burks* involved the extent to which Federal policy, as articulated in the Investment Company Act of 1940 (Investment Company Act), limits the power of directors of an investment company to terminate derivative litigation brought by its shareholders. Shareholders of an investment company registered under the Investment Company Act sued the company's directors and its registered investment adviser. The plaintiffs alleged that the defendants had violated their duties under the Investment Company Act and the Investment Advisers Act in connection with a purchase by the company of Penn Central commercial paper. The investment company's disinterested directors concluded that the suit was contrary to the best interests of the company and its shareholders and moved the district court to dismiss the action, which motion was granted.

The United States Court of Appeals for the Second Circuit held that the Investment Company Act deprives independent directors of an investment company of authority to terminate non-frivolous derivative litigation. The Commission appeared *amicus* before the Supreme Court, contending that the Investment Company Act does permit investment company directors to terminate such litigation, but only if they are independent, fully informed, and their decision is reasonable. The. Commission's primary purpose in participating was to persuade the Court that consideration of State and Federal law must be balanced and that Federal law imposes a minimum standard on directors' decisions to terminate derivative litigation, notwithstanding any lesser standard of State law.

The Supreme Court held that State law governing the authority of independent directors to discontinue derivative suits should be

applied to the extent State law is consistent with the policies of the Investment Company and Investment Advisers Acts. The Court reasoned:

"Although [a] state statute cannot be considered 'inconsistent' with federal law merely because the statute causes the plaintiff to lose the litigation . . . , federal courts must be ever vigilant to insure that application of state law poses no significant threat to any identifiable federal policy or interest. . . .

"And, of course, this means that unreasonable ... or specific aberrant or hostile state rules . . . will not be applied. . . . The consistency test guarantees that [n]othing that the state can do will be allowed to destroy the federal right . . ., and yet relieves federal courts of the necessity to fashion an entire body of federal corporate law out of whole cloth."

Accordingly, the Court remanded the case so that the Court of Appeals could determine the scope of directors' authority under State law to terminate derivative litigation, and determine whether State law is consistent with the policies of the Investment Company Act and the Investment Advisers Act. With respect to this latter inquiry, the Supreme Court observed that there may well be "situations in which the independent directors could reasonably believe that the best interests of the shareholders call for a decision not to sue. . . ." The implication of this language is that it would be inconsistent with Federal policies to give effect to a board of directors' decision which is unreasonable – a principle urged by the Commission.

Ludlow Corporation v. SEC – In *Ludlow,* the United States Court of Appeals for the District of Columbia Circuit affirmed the order of the Commission approving the application of the Boston Stock Exchange (BSE) for unlisted trading privileges in the common stock of Ludlow Corporation (Ludlow). *Ludlow* raised the issue of whether an exchange, in applying for unlisted trading privileges in a stock, must demonstrate that active trading in the stock will take place in its market. In approving the BSE's unlisted trading application, the Commission rejected such a requirement, in keeping with the

Commission's long-standing policy, endorsed by Congress, of liberally granting unlisted trading privileges as a means of promoting competition among the nations securities markets.

In affirming the Commission's order, the Court of Appeals emphasized the importance which Congress attached to the liberal grant of unlisted trading privileges as a means to foster competition among exchanges, and the role which unlisted trading must play in achieving the objectives of a national market system. In specific, the Court also clarified that the Commission's grant of unlisted trading privileges does not require a determination that an active market will develop on the applicant exchange. Rather, an applicant need only show that if an active trading should develop, it will proceed in a fair and orderly manner. As a result of *Ludlow,* the Commission has received renewed support to pursue a liberal approach in granting unlisted trading privileges, thereby enhancing the Commission's ability to facilitate intermarket competition in a national market system.

Belenke v. SEC – In *Belenke,* the United States Court of Appeals for the Seventh Circuit affirmed the Commission's order approving a proposed rule change of the Chicago Board Options Exchange (CBOE) to improve the CBOE's system for handling and executing "limit" orders of public customers. "Limit" orders are those which specify a minimum price at which a customer is willing to sell, or alternatively, a maximum price at which a customer is willing to buy a particular security. Prior to the Commission's approval of the CBOE rule, members of the CBOE were given exclusive appointments as board brokers to accept limit orders in particular options from other brokers on the floor, to store those orders in limit order books, and to assure timely execution of those orders when, and if, the prevailing market price matched the specified limit order price. The CBOE rule eliminates the system of exclusive appointment of board brokers, and instead permits the CBOE directly to provide limit order book services through employees known as "order book officials."

In its order approving the CBOE rule pursuant to Section 19(b) of the Exchange Act, the Commission found that the rule would further

several purposes of the Act – by improving the efficiency of the CBOE's market, enhancing the floor surveillance capabilities of the CBOE, and fostering competition between the CBOE and other options exchanges. The Court of Appeals, in affirming the Commission's order in all respects, stressed that the Commission's findings were predictive, policy-oriented decisions, and hence judicial deference to the Commission's expertise was particularly appropriate. Applying a limited scope of review, the Court of Appeals found that the Commission's substantive findings were not arbitrary or capricious. The Court also found that the informal notice and comment procedures followed by the Commission comported with the requirements of the Exchange Act. The Court thus rejected petitioners' argument that the more elaborate procedures of Section 6(e) of the Exchange Act were inapplicable, since the fees for limit order services under the CBOE rule were not fees "charged by members," but rather were fees charged by the CBOE itself.

The *Belenke* decision is of importance both to national securities exchanges and the Commission as judicial recognition of an exchange's ability to improve the operational efficiency of its market, consistent with the purposes of the Exchange Act. The Court of Appeals' decision reaffirms that judicial deference should be accorded to the decisions of the Commission in exercising regulatory or oversight authority over the operations of the nation's securities markets. Finally, this case gives effect to Congress' intent that the Commission have considerable flexibility in fashioning its administrative procedures where the Commission acts through informal, legislative-type proceedings.

Other Significant Projects

Implied Rights of Action – A number of cases were decided by the Supreme Court in the past term concerning implied rights of action, which have a substantial impact with regard to the Federal securities laws. In *Touche Ross & Company, Inc. v. Redington,* the Court refused to imply a private cause of action for violation of the books and recordkeeping provision of the Exchange Act, because that provision, in the Court's view, neither conferred special rights on

particular parties nor prohibited certain conduct as unlawful. Because the Court believed that the provision was intended by Congress to act as an early warning system – so that the Commission could pursue its enforcement obligations after reviewing the filings required to be made – implied actions have by no means been denied entirely.

The Court ordered that reargument be held in *Lewis v. Transamerica Mortgage Advisers, Inc.,* where the sole issue was whether private cause of action was implied for violations of the antifraud provision of the Investment Advisers Act. The Court had recognized the existence of private action under the comparable antifraud provision of the Exchange Act, in *Superintendent of Insurance v. Bankers Casualty & Life.* While the *Lewis* case has not yet been decided, the Court's opinion in non-securities cases, as well as *Touche Ross,* bear on the continued inability of private actions for the violations of some of the statutory provisions of the Federal securities laws.

ALI Code – Over the past ten years, the American Law Institute has sponsored the drafting of a Federal Securities Code, under the direction of Professor Louis Loss of the Harvard Law School. In May 1978, the Institute's membership approved a 766-page "Proposed Official Draft" of the Code, which is designed to replace the six separate Federal statutes administered by the Commission with a single comprehensive and unified piece of legislation.

The Commission and its staff spent a great deal of time and effort during the fiscal year analyzing and studying the proposed Code in preparation for its expected introduction in Congress. The task of evaluating the benefits the Code would offer and the possible difficulties it might create, in terms of maintaining an effective scheme of investor protection, is exceedingly complex. While in many respects the ALI draft seeks simply to codify existing law, it would make significant substantive changes in many other respects.

For example, the Code would replace the current emphasis on registration of individual offerings of securities with a "continuous disclosure" system based on issuer registration, and providing for less stringent filing and disclosure requirements in connection with

certain distributions of the securities of "one-year registrants" (i.e., issuers that have been registered for one year). In addition, certain changes would be made in tender offer regulation, including a ten-day preacquisition notice and publicity requirement, along with express preemption of State tender offer legislation. Also, investment advisers would be subject for the first time to qualification and financial responsibility requirements, and the Commission would be given rulemaking authority over the unethical conduct of securities professionals. In the area of civil liability, there would be many new express rights of action created, along with a grant of authority to the courts to imply private rights of action in certain circumstances. These are but a few of the literally hundreds of modifications that the Code would make as compared with current law.

During the initial review of the proposed Code, members of the Commission staff held a series of meetings with Professor Loss and his group of advisers to discuss concerns about both substantive positions taken in the Code and the drafting of various Code provisions. In response, Professor Loss has made a substantial number of technical amendments to the Code. In September 1979, the Commission itself began meeting with Professor Loss, in sessions open to the public, to discuss the issues raised by the staff. As the Code nears the beginning of Congressional consideration, the Commission will be drawing together the results of its review to help it determine what formal position to take before Congress with respect to the Code.

Public Utility Holding Companies

Composition

Under the Public Utility Holding Company Act of 1935 (Holding Company Act), the Commission regulates interstate public utility holding company systems engaged in the electric utility business or in the retail distribution of gas. The Commission's jurisdiction also covers natural gas pipeline companies and nonutility companies which are subsidiary companies of registered holding companies.

There are presently 14 registered holding company systems with aggregate assets, as of June 30, 1979, of $47.5 billion. Total holding company system assets increased by over $1.1 billion in fiscal 1979, even with the loss of Ohio Edison Company who was granted a Section 3(a)(2) exemption from the Holding Company Act in April 1979. Total operating revenues, as of June 30, 1979, were $17.9 billion, a $700 million increase over the previous year. In the 14 systems there are 60 electric and/or gas utility subsidiaries, 70 nonutility subsidiaries, and 20 inactive companies, or a total of 168 system companies, including the top parent and subholding companies. Table 35 in the Appendix lists the systems and Table 36 lists their aggregate assets and operating revenues.

Financing

During fiscal year 1979, approximately $2.7 billion of senior securities and common stock financing of the 14 registered systems was approved by the Commission. Of this amount, approximately $1.6 billion was long-term debt financing, and over $1 billion was for equity financing. These amounts represent a 24 percent decrease in long-term debt financing over fiscal year 1978 and a 19 percent increase in the sale of common and preferred stock. In addition, the Commission approved over $3.5 billion of short-term debt financing

and $291 million of pollution control financing for the 14 registered holding company systems.

Fuel Programs

During fiscal year 1979, the Commission authorized $460.6 million of fuel exploration and development capital expenditures for the holding company systems. These expenditures cover annual fuel programs subject to regulation under the Holding Company Act defined on geographical and functional terms.

Largely as a result of the energy crisis, holding companies have embarked on major and expensive new commitments to acquire substantial additional capital. Generally, the arrangements involve formation of several new subsidiaries for producing, transporting and financing fuel supplies or the investment of capital for the exploration of and development drilling for mineral reserves with a right to production accruing to such investment. Since 1971, the Commission has authorized expenditures of over $2.6 billion for fuel programs of holding companies.

Service Company Operations

At the end of calendar year 1978, there were 11 subsidiary service companies providing managerial, accounting, administrative and engineering services to 11 of the 14 holding companies registered under the Holding Company Act. The billings for services rendered to the holding company systems amount to $423 million or 2.37 percent of the total revenues generated by the electric and gas operating utilities of the holding company systems. All services are rendered at cost to the operating utilities, with several systems including a return on capital in vested by the parent holding company. Because the subsidiary service companies are service oriented, they are heavily labor intensive having 11,061 employees and assets of over $229 million. During February 1979, the Commission approved a proposed amendment to the Uniform System of Accounts for public utility service companies. The revised system of accounts will (1) provide for closer coordination with the Federal Energy Regulatory

Commission's Uniform System of Accounts for electric and gas public utilities, (2) facilities for conduct of audit and account inspection programs, and (3) improve reports filed by service companies subject to the Act. The revised system of accounts is effective January 1, 1980, for the 11 subsidiary service companies.

Corporate Reorganizations

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

Where the scheduled indebtedness of a debtor corporation exceeds $3 million, Section 172 of Chapter X requires the court, 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 court may, if it 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 summaries must be sent to all security holders and creditors when they are asked to vote on the plan. The Commission has no authority to veto a plan of reorganization or to require its adoption.

The Commission has not considered it necessary or appropriate to participate in every Chapter X case. Apart from the excessive administrative bur den, 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 court requests the Commission's participation.

The Commission in its Chapter X activities has divided the country into five geographical areas. The New York, Chicago, Los Angeles and Seattle regional offices of the Commission each have responsibility for one of these areas. Supervision and review of the regional offices' Chapter X work is the responsibility of the Division of Corporate Regulation of the Commission which, through its Branch of Reorganization, also serves as a field office for the southeastern area of the United States.

During the fiscal year, the Commission entered three new Chapter X proceedings involving companies with aggregate stated assets of approximately $69.9 million and aggregate indebtedness of approximately $93.6 million. Including the new proceedings, the Commission was a party in a total of 97 reorganization proceedings during the fiscal year (a list of these proceedings appears in Table 39 in the Appendix of this report). The stated assets of the companies involved in these proceedings totaled approximately $4.9 billion and their indebtedness about $4.5 billion. During the fiscal year nine proceedings were closed, leaving 88 in which the Commission was a party at year end.

Administration and Management

During the fiscal year 1979, the Commission stressed, more than ever before, its commitment to improving management information systems and strengthening internal management capabilities. This heightened emphasis on enhanced administrative and managerial support is a direct reflection of increased recognition of potential benefits that can flow to the public from better systems, procedures, plans, and organization structures. It is intended that the initiatives of 1979 will emerge in the form of operational economies, increased effectiveness and greater responsiveness in the 1980's.

General Management and Program Developments

The Commission undertook several projects during the fiscal year which resulted in management improvements and program efficiencies.

A management study conducted by the Executive Director's Office in fiscal year 1978 was the catalyst for organizational changes in the Division of Corporation Finance that will be implemented during the next fiscal year. Major recommendations for the study concerned development of a review strategy for disclosure filings and the need to restructure the division's workload by industry groupings so as to allow Commission staff an opportunity to develop expertise concerning peculiar industry patterns and trends, and to allow more informed review of priority filings. During 1979, a Corporation Finance task force studied these recommendations to assess their feasibility and to propose a plan for implementation. Based on the findings of the task force, a plan for such a restructuring was accepted and is intended for implementation during fiscal 1980. At the close of the fiscal year, negotiations were underway, with faculty from the Harvard Business School, to provide expertise and assistance in implementing industry specialization, a new and cost effective filings review strategy, and a quality control program.

An intensive workload/cost analysis of the Chicago Regional Office resulted in decisions to close the Cleveland and St. Louis Branch Offices and to consolidate these operations with those of the parent office in Chicago. This decision was based on a changing dispersion of activities due to the emergence of options markets in Chicago, a reduction of enforcement activity in the branches and development of specialized units in Chicago. Apart from major operational improvements, it was also concluded that there were some cost benefits to be derived from taking advantage of the economies of scale available through consolidation of activities at the principal office.

An organizational analysis of the Office of Public Affairs led to a decision to split the legislative and public information functions. A new Office of Legislative Affairs was created within the Office of the Chairman and given responsibility for handling matters relating to legislation and legislative liaison. The Office of Public Affairs will continue to handle general public information and press relations functions.

The Office of the Executive Director conducted a major management review of the Division of Market Regulation. The study report to the director and management staff of the division resulted in significant changes in both internal procedures and organizational structure. The study also served as a basis for an increased focus, within the division, on such issues as communication, project management, training, recruitment, and financial recordkeeping and controls.

Information Systems Management

In fiscal year 1979 the Commission made vast progress toward improving its information handling processes. Detailed specifications regarding computer processing capabilities that will be required to meet the agency's data processing needs over the next five to eight years were completed, and a formal request for delegated procurement authority was presented to the General Services Administration (GSA). In anticipation of GSA approval, steps were

taken to develop solicitation documents that will result in the installation of a new computer system by the end of fiscal year 1980.

Facilities Improvement – While much was accomplished in fiscal year 1979 toward meeting its long-term information processing needs, the Commission continued to make more efficient and effective use of the existing IBM 360-65 computer installed in 1978. In this regard, the memory capacity of the central processing unit was increased and several components were added to expand our on-line storage capability – two actions that enabled the Commission to process an immensely increased workload without any degradation in system performance. Other steps taken to improve processing activities included conversion to a more efficient operating system control program and utilization of on-line programming and file maintenance techniques. As a result of these improvements the Commission has been able to continue to make significant progress in the development and implementation of new information systems while concurrently expanding the use of the teleprocessing network to include all of the Commission's regional offices. The network was scheduled to be further extended to include four of the largest branch offices during the first quarter of fiscal 1980, with the remaining branches scheduled to come on line later in the year.

Major System Enhancements – Major information systems implemented during 1979 included two systems for which developmental work was initiated in 1978. The first was a comprehensive records management system which, utilizing microfilm and teleprocessing techniques, provides the staff with the capability for directly entering and retrieving information relating to the receipt and disposition of various reports filed with the Commission. As part of this project, on February 5, 1979, the Commission officially adopted microfilm as a substitute record for many of the paper files previously maintained. Under this mode of operation, microfiche copies of filings can be easily and quickly reproduced and distributed to all requesters, thus ensuring the highest possible level of integrity as the official file is centrally retained at all times. Expansion of the micrographics program to include additional Commission files was scheduled for the first and second quarter in fiscal 1980.

The second system involves an expansion of the Commission's Name and Relationship Search system. The new process provides the staff with a facility for immediate terminal access to an index of name and associated data on companies and individuals having a direct or indirect relationship with the Commission, and replaces a system of manual requests which very often required several days to process. A third system initiated in 1978, for which extensive development work was accomplished in 1979, is the Commission's Case Activity Tracking System (CATS). Scheduled for operational testing early in fiscal year 1980 and implementation in the second quarter, this system will promote better management by providing the Commission with an efficient means of monitoring current events and status of all active investigations and litigation.

Other important systems work pursued in 1979 included the initiative of a prototype correspondence tracking system to more effectively control the thousands of pieces of correspondence flowing through the Office of the Chairman, refinement and enhancement of various internal personnel, position management, and cost accounting systems; expansion of the complaint processing system to allow for the experimental preparation of letters and notices by means of automated electronic techniques; development of a series of statistical programs for use by the Commission's staff in its special study of the options market; expansion of the broker dealer/investment adviser data base to produce various statistics incidental to a corporate governance study being conducted by the Division of Corporation Finance; and development of a system for maintaining and reporting data filed pursuant to Section 4(2), Rule 146, of the Securities Act of 1933 (Securities Act).

Developmental work on several other information systems was also initiated during fiscal year 1979, many of which will be implemented by fiscal year 1980. These included establishment of a generalized, user-oriented information retrieval capability that will operate through teleprocessing and data base management techniques; expansion of an existing system for analyzing data contained in Investment Company Annual Reports, Form H-1R; creation of an on-line system

for retrieving index information relating to releases published in the SEC Docket; and development of a series of computer programs for producing a variety of reports from data filed by certain institutional investors and investment managers under Rules 13d, 13f, and 13g.

Systems Administration – In addition to these enhancements of agency information systems and automated processing techniques, several other measures were taken in fiscal year 1979 to enhance the internal management and administration of the Commission's data processing activity. An important event was the reorganization of the Office of Data Processing designed to make it more adaptable and responsive to the changing nature of the Commission's automated data processing (ADP) needs. A second undertaking involved an intensive program to enhance interrelationship between the ADP staff and the users of ADP services. This was accomplished through the adoption of a formal procedure for identifying and requesting ADP support, the creation of a Commission-wide ADP liaison group, and the establishment of more effective communication procedures to insure that critical information was effectively relayed to and from ADP personnel. Another step taken to increase ADP efficiency was the elimination of internal cardpunching and transfer of this function to a commercial concern. In addition to substantial dollar savings, this action has provided the Commission with much more flexibility in responding to changing data entry requirements.

One final issue receiving much emphasis during 1979 was ADP security. Recognizing that an expanded ADP program would require much tighter control and protection of ADP resources, the Commission has taken several actions toward bolstering its ADP security program. These included the establishment of a full-time position of ADP security officer, the conduct of an ADP risk assessment (to be completed early in fiscal year 1980), formalization of an interagency agreement for back-up computer processing time, and establishment of a personnel screening program for ADP staff, as mandated by the Office of Personnel Management (OPM).

Market Oversight Surveillance System

The Office of the Executive Director, in cooperation with the Divisions of Enforcement and Market Regulation and utilizing the services of an independent systems consultant, has been engaged in the study and design of a market oversight and surveillance system during the past year. That project has resulted in a proposed design, which is presently being reviewed by the Commission staff. In addition, the Commission is undertaking to implement a pilot of the proposed design in order to test the design and evaluate its potential for enhancing the Commission's oversight and surveillance functions. Budgetary approval by the Office of Management and Budget (OMB) and Congress and procurement approval by GSA will be required before any portion of the larger overall system can be implemented. By mid spring 1980 the Commission is hopeful that a determination will have been made as to the scope and timetable for implementation of a larger system. The proposed system would monitor all securities markets activities and seek to identify possible market irregularities or violations of self-regulatory organization rules and the Federal securities laws. It would thus enhance existing Commission facilities in areas such as market surveillance and inspections of self-regulatory organizations and broker-dealers. Such a system will neither diminish nor supplant the efforts of self-regulatory organizations to regulate their market places and market professionals; rather it is intended to provide the Commission with a greater capability to detect and follow-up on aberrant trading practices, particularly when subjects outside the jurisdiction of the self-regulatory organizations are involved. By providing the Commission with enhanced information analyzed for particular trading patterns, the system will place the Commission in a better position to coordinate, with each self-regulatory organization, the investigation and follow-up of particular matters.

If the proposed system receives the approval of the requisite governmental bodies, implementation is expected to require at least five years. Implementation will be geared to advancements in the securities industry and to developments in the evolving national market system.

Financial Management

The Commission collects fees for the registration of securities, securities transactions on national securities exchanges, and miscellaneous filings, reports and applications. In fiscal year 1979, the Commission collected a record $33 million dollars in fees, representing approximately 47 percent of the total funds appropriated by the Congress for Commission operations. These figures are up from $26 million, representing 42 percent of funds appropriated in fiscal year 1978. Nearly $4 million of the increase in collections was attributed to Securities Act registration fees resulting from both higher volumes and larger offerings, while higher stock exchange volumes accounted for $2.3 million of the increase.

In 1979, the Office of the Comptroller initiated implementation of an automated integrated financial management system. By the end of the fiscal year, the system was producing comprehensive accounting and budget execution reports which provide timely information for budgetary review and policy planning both Commission-wide and by organizational unit.

Fiscal year 1979 also saw partial implementation of a budget formulation system. Reports generated by this system present budgetary alternatives at various levels of staffing and funding, and are of considerable benefit in analyzing different zero base budget possibilities.

A position tracking system, developed in fiscal year 1979, has been implemented and will be fully operational in the first quarter of fiscal year 1980.

Other current initiatives intended to improve financial management or conserve resources include completion of a budget handbook, continued automation of payroll, fee collection and budget call procedures, and establishment of uniform agency policies on the use of overtime and the employment of temporaries. These projects will all be carried over into fiscal year 1980.

Personnel Management

At the close of the fiscal year, the Commission's total strength was approximately 2,020. About two-thirds of these personnel were employed in the agency headquarters in Washington, D.C.; the remaining one-third were located in the nine regional and six branch offices located in major financial centers throughout the United States.

Although relatively small by Federal agency standards, the Commission recognizes the importance of personnel management as an internal part of overall management effectiveness. It has, therefore, initiated innovative programs leading to both more effective use of personnel resources and the integration of personnel management into general decision-making. Enactment of the Civil Service Reform Act of 1978 (CSRA) has encouraged and accelerated these Commission initiatives. The intent of the CSRA is to place greater stress on performance, to give managers the tools needed to carry out their assignments and to hold managers accountable for the effectiveness of their units. As a result, a very substantial investment of staff time and funds has been devoted to the implementation of the Act, and an even greater commitment will be required in fiscal year 1980. Although the full benefit of this investment will not be realized for several years, significant accomplishments are already noticeable during the first year of the CSRA's existence.

Senior Executive Service – The Commission was allotted 46 senior executive positions in the initial Senior Executive Service (SES) allocation, 44 of which were filled by incumbents, as provided by the new law.

Extensive training was given to senior executives regarding the objectives and policies of the senior executive service. This training included in-depth briefings by officials for OPM, working seminars of senior executives conducted by the Chairman and the Executive Director, and training sessions presented by personnel consultants. This training program had as its purpose education of key Commission officials as to the flexibilities and opportunities offered by the CSRA for increased effectiveness in personnel management.

Based on a careful review of the literature, interviews and personnel specialists from academia and from the private sector, and a review of programs in other agencies, a performance appraisal system has been developed and implemented for the members of the SES. This system, which will be used as a basis for determining assignments and compensation, will be monitored closely to identify necessary refinements and to ensure that it continues to meet all of the objectives prescribed by the CSRA. Finally, an Executive Resource Board and a Performance Review Board have been established to oversee and coordinate manpower planning, recruiting, performance appraisals and other aspects of executive personnel management.

Performance Appraisal – A great deal of research and planning has gone into the development of performance appraisal systems at the Commission. A comprehensive promotion appraisal program being conducted by OPM (and reported in the 1978 Annual Report) is continuing. When completed, this program is expected to replace fairly subjective judgments with valid indicators of successful performance in attorney positions. In addition to achieving a higher degree of equity in awarding promotions, it is hoped that the new system will enable Commission managers to predict success in specific positions with a higher degree of accuracy.

This effort is complemented by a separate study being undertaken by a private consultant and an anticipated contract with other consultants from OPM. When these studies are completed, it is expected that they will provide the basis for a comprehensive, valid and equitable appraisal system for managers, supervisors, professional staff members and clerical personnel.

Other Accomplishments Under the CSRA – Procedures have been developed and implemented for the establishment of a probationary period for newly appointed managers and supervisors, as provided in Title III of the CSRA. This program enables division directors and office heads to promote qualified technicians and specialists into supervisory positions, with the understanding that they can revert back to prior positions after six months if they do not give evidence of

supervisory effectiveness. Planning is currently under way for the merit pay program required by Title V of the CSRA, under which supervisors and middle managers would be compensated on the basis of accomplishments and organizational performance, rather than on the basis of length of service.

On-going Programs – Title III of the CSRA authorizes acceptance of volunteer services where they provide educational experiences for students. The Commission is making extensive use of this provision of the CSRA through its student observer program, under which law students work for the Commission for up to 20 hours a week. The students receive course credits in lieu of salary, as well as a first hand acquaintance with Federal employment. A number of student observers have already become permanent staff members following graduation from law school.

Despite the heavy investment of time devoted to implementation of the CSRA, the Commission continued to stress and initiate improvements in other traditional areas of human resource management.

The Commission has continued to refine its attorney recruitment system, with the dual goal of attracting top caliber applicants and ensuring that persons employed represent a cross section of all segments of American society. One notable achievement in fiscal year 1979 was the Commission's special effort to attract minority law graduates. This was accomplished by means of an enormously successful "job fair" to which 129 law students were invited. The students heard presentations from the Chairman, several Commissioners, the Executive Director and the heads of all major offices, resulting in the permanent employment of 11 minority attorneys and summer job opportunities for four second year students. Another program, carried out under the sponsorship of the Office of General Counsel, resulted in the hiring of four outstanding graduates who had served as law clerks to district and appellate court judges.

The highly successful upward mobility program instituted in fiscal year 1978 was continued and expanded. Ten additional upward mobility positions were established, bringing the total number of positions under this program to 22. This number, however, only partially reflects the Commission's progress in upward mobility. As a direct result of early successes with this program, a number of entry-level positions were established outside the formal program; this will further assist the agency in using the capabilities of its existing staff, while at the same time providing other bonafide advancement opportunities for lower grade employees.

The Commission continued to emphasize staff training in fiscal year 1979. Approximately 850 of the Commission's 2,000 staff members attended formal training or development programs during the year, an approximate 10 percent increase over 1978.

In particular, more staff time and funds were allocated to managerial and executive development than in any previous year. The Commission was represented at the Federal Executive Institute's (FEI) seven week Senior Executive Education Program for the first time, while five other senior managers participated in FEI's three week leadership program. In addition, other key staff members attended the Program for Senior Managers at Harvard Business School, Managerial Grid, team building programs and a program sponsored by the National Institute of Trial Advocacy at the University of Colorado. This emphasis reflects recognition of the increased attention to executive development that is required by the CSRA, and will be further expanded in fiscal year 1980.

The employee counseling program begun in fiscal year 1978 was expanded in an effort to be more responsive to the needs of employees, and to enhance the role of the Commission as a responsible and concerned employer. A discrete Employee Relations unit was established in the Office of Personnel, and its accomplishments numbered among them expanded retirement counseling, counseling on financial planning, and more comprehensive counseling on insurance plans.

The Commission conducted an aggressive Vietnam Veterans Week program, consistent with the spirit of the Congressional resolution on this subject. The thrust of the program was to sensitize the staff to the particular needs of the Vietnam veteran, to promote the hiring and professional development of these veterans, and to recognize their post-service as well as service accomplishments.

The Commission also continues to emphasize its highly successful program for the recruitment of handicapped persons. This effort reflects a commitment to remove artificial barriers – both architectural and attitudinal – to the employment of full utilization of individuals who, despite handicapping conditions, are able to make a meaningful contribution to Commission objectives.

Equal Employment Opportunity – In response to Title III of the CSRA, the Commission has undertaken extensive efforts to identify underrepresentation of minorities and women on the staff, both by grade level and by occupation. Strategies are being implemented to correct the underrepresentation through enhanced recruiting efforts directed to schools with large minority and female enrollment, maintenance of equal opportunity recruitment files, expansion of the upward mobility program, activation of individual training and development plans, and cooperation with OPM in eliminating many of the complex procedures and requirements which have raised barriers to the recruitment and hiring of minorities and women. These procedural efforts will be combined with seminars for managers and supervisors designed to stress recognition of EEO responsibilities and provide instructions in the strategies which may be employed to eliminate underrepresentation.

In part because of these efforts, the total number of women attorneys in the work force at the Commission continues to increase. Since 1977, 63 women attorneys obtained employment at the Commission, bringing their total representation to 168 as of the end of fiscal 1979. This increase represents a 60 percent rise in female attorney employment during the two year span.

Correspondent to the rise in the number of women attorneys, there has been an overall increase in their total percent of the Commission's attorney work force. In 1977, women attorneys represented 16.4 percent of the total work force, whereas 22.5 percent of attorney positions were held by women in 1979.

Minority attorney employment rose a healthy 21.4 percent during the period between 1977 and 1979. At the end of fiscal year 1979, there were 51 minority attorneys employed at the Commission as compared to 42 in 1977, 33 in 1975, and 11 in 1973.

Minorities generally registered across the board gains in key professional and middle management positions (GS - 13-15) between fiscal years 1977 and 1979. At the close of fiscal year 1977, there were only 37 minorities occupying positions in these grades in contrast to 49 at the end of fiscal year 1979, for a 32.4 percent increase during the two year period. Similarly, women also showed an increase during this period – holding 82 GS-13 through 15 positions, up from 56 in 1977.

Activity Under The Freedom Of Information Act

Commission rules implementing the Freedom of Information Act provide that the public may inspect or obtain copies of records maintained by the Commission, with the exception of certain specified categories of information. During 1979, the Commission received 1,318 requests for information; up 5 percent from 1978.

Space Management

Problems stemming from inadequate and poorly planned space continue to present some of the Commission's most serious operational difficulties. Headquarters personnel are scattered among three locations, requiring costly, time consuming and inefficient movement of equipment, personnel and files. Some $150,000 is spent on alterations each year in an attempt to accommodate changing staff requirements. In fiscal year 1979, documentation for a

consolidated Headquarters building was again prepared and submitted to GSA.

In the meantime, the Office of Administrative Services and the Division of Corporation Finance have continued to work with GSA in connection with the refurnishing and alterations necessary to allow for the eventual movement of Commission personnel from the sixth and seventh floors of the old Federal Home Loan Bank Board building to the third and fourth floors.

FOOTNOTES

[1]Securities Exchange Act Release No. 15251 (October 20, 1978), 15 SEC Docket 1370.

[2]Securities Exchange Act Release No. 15250 (October 20, 1978), 15 SEC Docket 1355.

[3]Securities Exchange Act Release No. 15671 (March 22, 1979), 17 SEC Docket 24.

[4]Securities Exchange Act Release No. 15770 (April 26, 1979), 17 SEC Docket 369.

[5]Securities Exchange Act Release No. 16214 (September 21, 1979), 18 SEC Docket 467.

[6]Securities Exchange Act Release Nos. 15413 (December 15, 1978) and 16215 (September 21, 1979), 16 SEC Docket 510 and 18 SEC Docket 475.

[7]Securities Exchange Act Release No. 15769 (April 26, 1979), 17 SEC Docket 361.

[8]Securities Exchange Act Release No. 15926 (June 15, 1979), 17 SEC Docket 950.

[9]*Bradford National Clearing Corporation et al. v. Securities and Exchange Commission et al,* 590 F.2d 1085 (D.C. Cir 1978).

[10]Securities Exchange Act Release No. 15640 (March 14, 1979), 16 SEC Docket 1318.

[11]*Id.*

[12]44th Annual Report at 6.

[13]Securities Exchange Act Release Nos. 13760 (June 18, 1977), 12 SEC Docket 1275; 14056 (October 17, 1977), 13 SEC Docket 366; 14057 (October 17, 1977), 13 SEC Docket 375; 14878 (June 22, 1978), 15 SEC Docket 98; 15026 (August 3, 1978), 15 SEC Docket 494; and 14991 (July 25, 1978), 15 SEC Docket 359.

[14]House Comm. on Interstate and Foreign Commerce, 96th Cong., 1st Sess., Report of the Special Study of the Options Markets to the Securities and Exchange Commission (Comm. Print 1978).

[15]*Id.* at 1.

[16]*Id.*

[17]Securities Exchange Act Release No. 15575 (February 22, 1979), 16 SEC Docket 1163.

[18]Securities and Exchange Commission file Nos. SR-Amex-79-11, Securities Exchange Act Release No. 16145 (August 29, 1979), 18 SEC Docket 195; SR-CBOE-79-9, Securities Exchange Act Release No. 16127 (August 21,1979), 18 SEC Docket 162; SR-MSE-79-18, Securities Exchange Act Release No. 16254 (October 5, 1979), 18 SEC Docket 612; SR-Phlx-79-7, Securities Exchange Act Release No. 16253 (October 5, 1979), 18 SEC Docket 611; and SR-PSE-79-13, Securities Exchange Act Release No. 16234 (October 2, 1979), 18 SEC Docket 561.

[19]Securities Exchange Act Release No. 15762 (April 24, 1979), 17 SEC Docket 356.

[20]44th Annual Report at 13.

[21]Securities Exchange Act Release No. 15241 (October 18, 1978), 15 SEC Docket 1319.

[22]Securities Exchange Act Release No. 15765 (April 27, 1979), 17 SEC Docket 416.

[23]Securities Exchange Act Release No. 16017 (July 11, 1979), 17 SEC Docket 1243.

[24]Securities Exchange Act Release No. 15533 (January 29, 1979), 16 SEC Docket 854.

[25]Securities Exchange Act Release No. 16049 (July 27, 1979), 17 SEC Docket 1475.

[26]Securities Exchange Act Release No. 16112 (August 16, 1979), 18 SEC Docket 67.

[27]Securities Exchange Act Release No. 14234 (December 14, 1977), 13 SEC Docket 999.

[28]Securities Act Release No. 6099 (August 2, 1979), 17 SEC Docket 1422.

[29]Securities Act Release No. 5979 (September 19, 1978), 15 SEC Docket 1109.

[30]Securities Exchange Act Release No. 15289, (November 1, 1978), 16 SEC Docket 12.

[31]Securities Exchange Act Release No. 15683 (March 29, 1979), 17 SEC Docket 92.

[32]Securities Exchange Act Release No. 15867 (May 23, 1979), 17 SEC Docket 698.

[33]Exchange Act Rule 10b-10. Certain paragraphs of the rule became effective on June 1, 1977. Securities Exchange Act Release Nos. 13508 (May 5, 1977), 12 SEC Docket 299; and 14942 (July 7, 1978), 15 SEC Docket 245.

[34]Securities Exchange Act Release No. 15219 (October 6, 1978), 15 SEC Docket 1245.

[35]Securities Exchange Act Release No. 15220 (October 6, 1978), 15 SEC Docket 1260.

[36]Securities Exchange Act Release No. 15984 (July 2, 1979), 17 SEC Docket 1167.

[37]Securities Exchange Act Release No. 16018 (July 11, 1979), 17 SEC Docket 1244.

[38]Commodity Exchange Act, 7 U.S.C. §2 (1977).

[39]43 FR 39956 (September 8, 1978).

[40]Securities Exchange Act Release No. 15898 (June 5, 1979), 17 SEC Docket 810.

[41]Securities Exchange Act Release No. 15899 (June 5, 1979), 17 SEC Docket 819.

[42]15 U.S.C. §78aaa-78///, as *amended by* the Securities Investor Protection Act Amendments of 1978, Pub. L. No. 95-283, 92 Stat. 249.

[43]Securities Investor Protection Act Release No. 78 (October 20, .1978), 15 SEC Docket 1438.

[44]Securities Investor Protection Act Release No. 86 (March 30, 1979), 17 SEC Docket 235.

[4]517 C.F.R. *300.100 et seq.*

[46]Securities Exchange Act Release No. 15906 (June 8, 1979), 17 SEC Docket 891.

[47]Securities Exchange Act Release No. 16156 (August 31, 1979), 18 SEC Docket 237.

[48]Securities Exchange Act Release No. 14800 (May 25, 1978), 14 SEC Docket 1178.

[49]Securities Exchange Act Release No. 15827 (May 15, 1979), 17 SEC Docket 589.

[50]Securities Exchange Act Release No. 15998 (July 5, 1979), 17 SEC Docket 1176.

[51]Securities Exchange Act Release No. 15376 (December 1, 1978), 16 SEC Docket 333.

[52]Securities Exchange Act Release No. 16049 (July 27, 1979), 17 SEC Docket 1475.

[53]Securities Exchange Act Release No. 15812 (May 11, 1979), 17 SEC Docket 582.

[54][1976-1977 Transfer Binder] Fed. Sec. L. Rep. (CCH) *195,627* (S.D.N.Y. 1976).

[55]Securities Exchange Act Release No. 15411 (December 13, 1978), 16 SEC Docket 435.

[56]Securities Exchange Act Release No. 15936 (June 19, 1979), 17 SEC Docket 985.

[57]Securities Exchange Act Release No. 15885 (May 30, 1979), 17 SEC Docket 754.

[58]Securities Exchange Act Release No. 16282 (October 16, 1979), 18 SEC Docket 673.

[59]Securities Exchange Act Release No. 15860 (May 23, 1979), 17 SEC Docket 695; Securities Exchange Act Release No. 16208 (September 18, 1979), 18 SEC Docket 403.

[60]Securities Exchange Act Release No. 14531 (March 6, 1978), 14 SEC Docket 356.

[61]Securities Exchange Act Release No. 16294 (October 24, 1979), 18 SEC Docket 728.

[62]Securities Exchange Act Release No. 15838 (May 18, 1979), 17 SEC Docket 678.

[63]Securities Act Release No. 6084 (June 25, 1979), 17 SEC Docket 1048.

[64]Securities Exchange Act Release No. 16226 (September 27, 1979), 18 SEC Docket 509.

[65]Securities Exchange Act Release No. 16162 (September 6, 1979), 18 SEC Docket 241.

[66]Report of the Advisory Committee on Corporate Disclosure, Chapter XIV, Page 427 (1977).

[67]Securities Exchange Act Release No. 13482 (April 28, 1977), 12 SEC Docket 239. Securities Exchange Act Release No. 13901 (August 29, 1977), 12 SEC Docket 1630.

[68]Securities Exchange Act Release No. 15384 (December 6, 1978), 16 SEC Docket 348.

[69]Securities Exchange Act Release No. 16104 (August 13, 1979), 18 SEC Docket 91.

[70]Securities Exchange Act Release No. 16356 (November 21, 1979) 18 SEC Docket 997.

[71]Securities Act Release No. 6003 (December 4, 1978), 16 SEC Docket 320.

[72]Securities Act Release No. 6027 (February 2, 1979), 16 SEC Docket 1138.

[73]Securities Act Release No. 6085 (June 25, 1979), 17 SEC Docket 1057.

[74]Securities Act Release No. 6115 (August 30, 1979), 18 SEC Docket 220.

[75]Securities Exchange Act Release No. 16163 (September 6, 1979), 18 SEC Docket 248.

[76]Securities Act Release No. 6130 (September 27, 1979), 18 SEC Docket 453.

[77]In the Matter of United States Steel Corporation, Securities Exchange Act Release No. 16223 (September 27, 1979), 18 SEC Docket 497.

[78]Securities Act Release No. 6032 (March 5, 1979), 16 SEC Docket 1261.

[79]Securities Act Release No. 6075 (June 1, 1979), 17 SEC Docket 798.

[80]Securities Act Release No. 6049 (April 3, 1979), 17 SEC Docket 153.

[81]*Id.*

[82]Securities Act Release No. 6121 (September 11, 1979), 18 SEC Docket 287.

[83]Securities Act Release No. 6136 (October 16, 1979), 18 SEC Docket 662.

[84]Securities Act Release No. 6022 (February 15, 1979), 16 SEC Docket 973.

[85]Securities Act Release No. 6158 (November 29, 1979), 18 SEC Docket 1053; Securities Act Release No. 6159 (November 29, 1979), 18 SEC Docket 1092; and Securities Act Release No. 6160 (November 29, 1979), 18 SEC Docket 1111.

[86]Securities Act Release No. 6100 (August 2, 1979), 17 SEC Docket 1449.

[87]Securities Exchange Act Release No. 15572 (February 15, 1979), 16 SEC Docket 1155.

[88]44th Annual Report at 21.

[89]Securities Exchange Act Release No. 15920 (June 14, 1979), 17 SEC Docket 877.

[90]Securities Act Release No. 6006 (December 19, 1978), 16 SEC Docket 477; Securities Act Release No. 6007 (December 19, 1978), 16 SEC Docket 492; Securities Act Release No. 6008 (December 19, 1978), 16 SEC Docket 498.

[91]Securities Act Release No. 6127 (September 20, 1979), 18 SEC Docket 384.

[92]Accounting Series Release No. 177 (September 10, 1975).

[93]Investment Company Act Release No. 10891 (October 4, 1979), 18 SEC Docket 637.

[94]Investment Company Act Release No. 10890 (October 4, 1979), 18 SEC Docket 635.

[95]Investment Company Act Release No. 10736 (June 14, 1979), 17 SEC Docket 937.

[96]Investment Company Act Release No. 10828 (August 13, 1979), 18 SEC Docket 122.

[97]Investment Company Act Release No. 10740 (June 20, 1979), 17 SEC Docket 1021.

[98]Investment Company Act Release No. 10690 (May 15, 1979), 17 SEC Docket 611.

[99]Investment Company Act Release No. 10827 (August 13, 1979), 18 SEC Docket 120.

[100]Investment Company Act Release No. 10809 (August 6, 1979), 18 SEC Docket 25.

[101]Investment Company Act Release No. 10862 (September 7, 1979), 18 SEC Docket 271.

[102]Securities Act Release No. 6034 (March 8, 1979), 16 SEC Docket 1267.

[103]*Id.*

[104]Securities Act Release No. 6140 (October 26, 1979), 18 SEC Docket 801.

[105]Securities Act Release No. 6116 (August 31, 1979), 18 SEC Docket 222.

[106]Investment Advisers Act Release No. 664 (January 30, 1979), 16 SEC Docket 901.

[107]Securities Act Release No. 6019 (January 30, 1979), 16 SEC Docket 837.

[108]Investment Advisers Act Release No. 680 (June 19, 1979), 17 SEC Docket 1029.

[109]Investment Advisers Act Release No. 688 (July 12, 1979), 17 SEC Docket 1293.

[110]*SEC v. Lummis,* Civ. Act. No. 75-1089AJ2 (N.D. Cal.), Litigation Release No. 8650 (January 19, 1979), 16 SEC Docket 833.

[111]E.g., *SEC v. International Telephone & Telegraph Corporation,* Civ. Act. No. 78-0807 (D.D.C.), Litigation Release No. 8834 (August 8, 1979), 18 SEC Docket 145.

[112]E.g., *SEC v. Rapid-American Corporation,* Civ. Act. No. 79-2128, (D.D.C., filed August 16, 1979), Litigation Release No. 8841 (August 16, 1979), 18 SEC Docket 149.

[113]E.g., *SEC v. The Starr Broadcasting Group, Inc.,* Civ. Act. No. 79-0357 (D.D.C., filed February 7, 1979), Litigation Release Nos. 8667 (February 7, 1979), 16 SEC Docket 1084, 8702 (March 26, 1979), 17 SEC Docket 147, 8713 (April 9, 1979), 11 SEC Docket 286, and 8792 (June 22, 1979), 17 SEC Docket 1137.

[114]E.g., *SEC v. American Financial Corporation,* Civ. Act. No. 79-1701 (D.D.C., filed July 2, 1979), Litigation Release No. 8806 (July 2, 1979), 17 SEC Docket 1219.

[115]*SEC v. Marlene Industries Corp.,* Civ. Act. No. 79-.1959 (S.D.N.Y., filed April 26, 1979), Litigation Release No. 8733 (April 26, 1979), 17 SEC Docket 406.

[116]SEC *v. The Fundpack, Inc.,* Civ. Act. No. 79-0859 (D.D.C., filed March 21, 1979), Litigation Release No. 8698 (March 22, 1979), 17 SEC Docket 72.

[117]SEC *v. Production Oil Corporation,* Civ. Act. No. 135R (D. Miss.), Litigation Release No. 8765 (May 24, 1979), 17 SEC Docket 792.

[118]*SEC v. Advanced Fuel Systems, Inc.,* Civ. Act. No. 78-759M (W.D. Wash., filed December 6, 1978), Litigation Release No. 8621

(December 21, 1978), 11 SEC Docket 581: *In the Matter of Asset Securities, Inc.,* Securities Exchange Act Release No. 16189 (September 12, 1979), 18 SEC Docket 317.

[119]*SEC v. Atlas Oil Exploration, Inc.,* Civ. Act. No. S-79-0259(r) (S.D. Miss., filed July 13, 1979), Litigation Release No. 8835 (August 13, 1979), 18 SEC Docket 146; *SEC v. High Valley Investments, Inc.,* Civ. Act. No. 76-39-M (D. Mont), Litigation Release No. 8846 (August 21, 1979), 18 SEC Docket 179; *U.S. v. Carter,* Crim. No. SA-78-CR-015 (W.D. Tex.), Litigation Release No. 8641 (January 11, 1979), 16 SEC Docket 801; *SEC v. Martin,* Civ. Action No. 78-918 PHX CAM (D. Ariz., filed December 1, 1978), 16 SEC Docket 582.

[120]*SEC v. Atlas Oil Exploration, Inc., supra* note 10; *U.S. u Jones,* Crim. Act. No. 78-30019 (W.D. La., Indictment filed September 30, 1978), Litigation Release No. 8566 (October 19, 1978) 15 SEC Docket 1349.

[121]*SEC v. Atlas Oil Exploration, Inc., supra* note 10.

[122]*SEC v. Advanced Fuel Systems, Inc., supra* note 9; *U.S. v. Trahan,* Crim. Act. No. 79-50008-01 (W.D. La., filed April 13, 1979), Litigation Release No. 8760 (May 17, 1979), 17 SEC Docket 652.

[123]*SEC v. Atlas Exploration, Inc., supra* note 10.

[124]*SEC v. Advanced Fuel Systems, Inc., supra* note 9.

[125]*SEC v. Hospital Corporation of America,* Civ. Act. No. 78-2027 (D.D.C., filed October 27, 1978), Litigation Release No., 8586 (October 27, 1978), 16 SEC Docket 72.

[126]*SEC v. Schenley Industries, Inc.,* Civ. Act. No. 79-0855 (S.D.N.Y., filed February 26, 1979), Litigation Release No. 8679 (February 26, 1 979), 1 6 SEC Docket 1 256.

[127]*SEC v. International Systems & Controls Corporation,* Civ. Act. No. 79-1760 (D.D.C., filed July 9, 1979), Litigation Release No. 8815 (July 9, 1979), 17 SEC Docket 1302.

[128]SEC *Annual Report 1978,* at 34.

[129]Securities Act Release No. 6021 (February 5, 1979), 16 SEC Docket 951.

[130]Securities *and Exchange Commission Staff Report on Transactions in Securities of the City of Hew York,* October 1977.

[131]*Ibid.*

[132]Securities Act Release No. 6021 (February 5, 1979), 16 SEC Docket 951, 959.

[133]*SEC v. Harwell,* Civ. Act. No. H-78-1916 (S.D. Tex., filed October 5, 1978), Litigation Release No. 8559 (October 5, 1978), 15 SEC Docket 1242; see also Litigation Release Nos. 8417 (May 24, 1978), 14 SEC Docket 1216, 8541 (September 20, 1978), 15 SEC Docket 1150, 8600 (November 21, 1978), 16 SEC Docket 261 and 8690 (March 13, 1979), 16 SEC Docket 1355.

[134]*United States v. Harwell,* Crim. Act. No. 787-H-78-87 (S.D. Tex.), Litigation Release No. 8600 (November 21, 1978), 16 SEC Docket 261.

[135]Securities Exchange Act Release No. 15719 (April 11, 1979), 17 SEC Docket 257.

[136]*Ibid.* at 259.

[137]*U.S. v. Speer.* Crim. Act. Nos. 77-10034-01 and 10062-01 (D. Kan., filed March 15, 1977), Litigation Release Nos. 8758 (May 17, 1979), 17 SEC Docket 651 and 8800 (June 27, 1979), 17 SEC Docket 1142.

[138]*SEC v. Roberts,* Civ. Act. No. 78-809 (W.D. Mo., filed October 16, 1978), Litigation Release Nos. 8564 (October 17, 1978), 15 SEC Docket 1347, and 8595 (November 6, 1978), 16 SEC Docket 139.

[139]*Ibid.*

[140]*Ibid.*

[141]SEC *Annual Report 1978,* at 31.

[142]*In the Matter of E.F. Hutton & Company, Inc.,* Securities Exchange Act Release No. 15537 (January 30, 1979), 16 SEC Docket 871; *SEC v. Fred Blumenstein,* 78 Civ. Act. No. 4805 (S.D.N.Y., filed October 13, 1978), Litigation Release No. 8569 (October 19, 1978), 15 SEC Docket 1350; *In the Matter of Robert T. O'Donnell,* Securities Exchange Act Release No. 15868 (May 24, 1979), 17 SEC Docket 743.

[143]*In the Matter of E.F. Hutton & Company, Inc., supra* note 34; *SEC v. Blumenstein, supra* note 34; *In the Matter of Robert T. O'Donnell, supra* note 34.

[144]*In the Matter of E.F. Hutton & Company, Inc., supra* note 34; *In the Matter of Robert T. O'Donnell, supra* note 34.

[145]Securities Exchange Act Release Nos. 16023 and 16025 (July 16, 1979), 17 SEC Docket 1313-15.

[146]SEC *v. Santangelo & Co.,* Civ. Act. No. 79-2097 (S.D.N.Y., filed April 23, 1979), Litigation Release No. 8729 (April 23, 1979), 17 SEC Docket 404.

[147]*SEC v. Telco Marketing Services, Inc.,* (D.D.C., filed July 13, 1979), Litigation Release No. 8821 (July 13, 1979), 17 SEC Docket 1362.

[148]*SEC v. Fuqua Industries, Inc.,* Civ. Act. No. 79-2204 (D.D.C., filed August 21, 1979), Litigation Release No. 8847 (August 21, 1979), 18

SEC Docket 180; *SEC v. BOC International Limited,* Civ. Act. No. 79-0888 (S.D.N.Y., filed February 24, 1979), Litigation Release No. 8673 (February 21, 1979), 16 SEC Docket 1193.

[149]*SEC v. Telco Marketing Services, Inc., supra* note 39; *SEC v. United Technologies Corporation,* Civ. Act. No. 79-1648 (D.D.C., filed June 25, 1979), Litigation Release No. 8793 (June 25, 1979), 17 SEC Docket 1137.

[150]*Supra* note 40.

[151]SEC *Annual Report 1978,* at 32.

[152]Litigation Release No. 8816 (July 10, 1979), 17 SEC Docket 1303.

[153]Securities Exchange Act Release No. 15994 (July 5, 1979), 16 SEC Docket 1172.

[154]Securities Exchange Act Release No. 16223 (September 27, 1979), 18 SEC Docket 497.

[155]Securities Act Release No. 5170 (July 19, 1971).

[156]Securities Act Release No. 5386 (April 20,1973), 1 SEC Docket No. 12, p. 1.

[157]Securities Act Release No. 5704 (May 6. 1976), 9 SEC Docket 540.

[158]SEC v. *Rapid-American Corporation, supra* note 3.

[159]*SEC v. The Fundpack, Inc., supra* note 7.

[160]*SEC v. The Starr Broadcasting Group, Inc., supra* note 4.

[161]*SEC v. American Financial Corporation, supra* note 5.