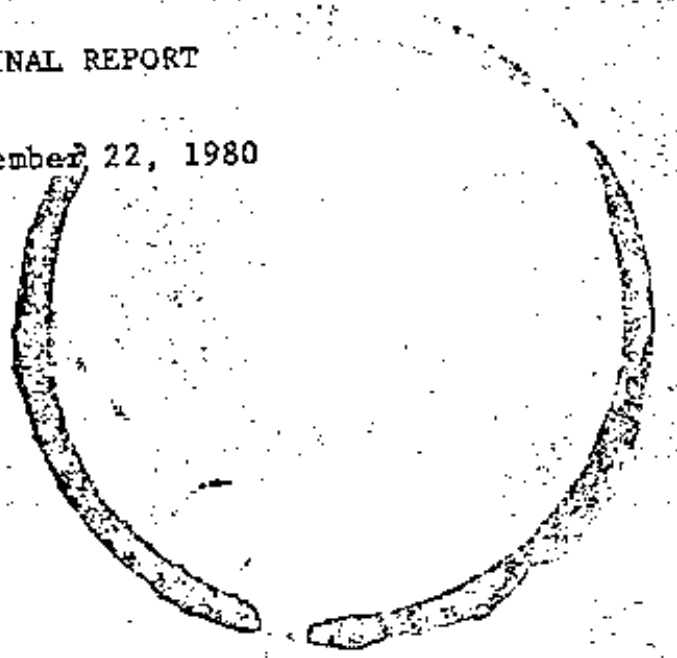
SEC TRANSITION TEAM

FINAL REPORT

December 22, 1980



I. INTRODUCTION

Early Decisions

A. Personnel - The Chairman

The major early decision for the President-elect is a decision on the leadership for this agency. On January 20, 1981, the President-elect will have the responsibility to decide the issue of who shall be designated Chairman. Chairman Williams has indicated he will resign, if replaced as Chairman. Thus, the President-elect should appoint a new Republican Chairman effective January 20, 1981. The next vacancy occurs on June 5, 1981, and should be used to strengthen control.

b. Policy Issues

There do not appear to be any improtant early policy decisions or major problem areas which need the attention of the President-elect prior to January 20, 1981, if a new Chairman is appointed prompty. A preliminary listing of certain regulatory matters presently being considered by the Commission is provided as an Appendix to Section II.

Listing of Those Individuals Involved in the SEC Transition Team

Dr. Roger W. Spencer	Team Captain
Daniel J. Piliero II	Policy Coordinator
Mary Lee Garfield	Budget
Lance Wilson	Personnel
David M. Barrett	Legislation

Major Problem Areas

None anticipated prior to January 20, 1981.

RECOMMENDATIONS

AND

EXECUTIVE SUMMARY

I. AGENCY OVERVIEW

The Securities and Exchange Commission with an authorized budget of $77 million and an authorized staffing of 2,100 persons, is responsible for three major program areas: disclosure, suppression of fraud and to a limited extent, regulation of the securities market activities. This report demonstrates how the staff and budget of the Securities and Exchange Commission can be reduced by approximately thirty (30) percent over a three year period without any compromise in the mission of the Agency.

The Report sets forth steps to be taken by the incoming administration in order to insure that the economic and deregulatory policy objectives of the Reagan Administration will be carried out promptly.

II. POLICY AND PROGRAM

A. Eliminating Regulatory Barriers To Capital Formation

Regulation of the financial activities of corporations and financial institutions should be limited to insuring that capital formation is facilitated and encouraged in an orderly process and with appropriate investor safeguards.

One of the principal objectives to be encouraged by the Reagan Administration is the elimination of unnecessary regulatory impediments to capital formation. It is only with effective capital formation that the goals of the Reagan

administration for economic growth and greater productivity can be fully achieved. While the Securities and Exchange Commission by no means has a major role to play in capital formation, the SEC can and does raise artificial barriers in certain circumstances to the free accumulation and formation of capital. This is done through regulations requiring excessive, unnecessary and costly initial registration and continuing disclosure requirements. In addition, decisions which the SEC makes may impair the growth and continuing development of the secondary securities markets thereby adversely affecting capital formation in the primary markets.

Therefore, the policy of the incoming SEC leadership should be to eliminate promptly those impediments to capital formation which are not essential to the mission of the agency.

B. Disclosure

The Securities and Exchange Commission is now engaged in a modest program of reducing some disclosure requirements. This report recommends that the incoming Reagan administration immediately establish as a priority the elimination of a great deal of the disclosure which is presently required, and is unnecessary for investor protection. Significant policy judgments should be made in the disclosure area early.

The incoming administration should eliminate all but the very essential registration and continuing disclosure requirements. The continuing review of filings in certain areas should

also be eliminated unless there is a demonstrated need for such review.

C. Fraud Suppression

If one assumes that a proper and sound program for disclosure exists which is simple, but yet contains the appropriate minimum information necessary for informed investor decision making, then an improtant ingredient to an effective regulatory program is a strong unit devoted to the suppression of fraud. However, in the present form, there appears to be a proliferation of meaningless enforcement activity directed at minor infractions while in areas where serious enforcement pursuit would be highly desirable, lighter penalties are accepted than those which seem appropriate. Additionally, this function has become centralized in the Washington, D.C. headquarters office without apparent justification.

Therefore, it is recommended that changes be made in this program to correct these imbalances.

D. Regulation of the Markets

The policy unit in the Commission which deals with the regulation of the marketplace is more than three times the size that it was seven years ago without apparent justification. This report recommends a reduction of force in this unit, as well as certain directional changes. This division has not dealt effectively with certain policy issues which have been pending for some time. It appears that in the past, there has been too aggressive an approach towards regulating an area which

can be and is corrected by market forces. At the same time, the Agency has created apparently unjustified monopolies in certain facets of the securities industry, such as options activity in underlying securities.

Therefore, the incoming administration should make policy decisions which will result in less government intervention in the free market activities of the securities industry. There should also be significant deregulation in the financial, operational, and reporting requirements imposed upon brokers and dealers by the Commission and at the Commission's request by the self-regulatory roganizations. Also, the private sector self-regulatory organizations should be encouraged to play a stronger role in the process.

III. BUDGET

The fiscal year 1981 authorized and approved budget for the Securities and Exchange Commission is $85.5 million; $98 million for FY 82; and $108 million for FY 83.

This report justifies a reduced budget level of $71 million for FY 81; $60 million for FY 82; and $53 million for FY 83. Presently scheduled and budgeted items such as the development of a MOSS computer system, the purchase of a new building, a samll business conference and a number of significant extraordinary budget expenses are foregone in this recommendation. In addition, a staff reduction to a level of 1,252 over a three year period is recommended with equivalent reductions in budget more carefully detailed in Part III of this Report. The Team

wants to emphasize that this budget is not a "bare bones" proposal. The reduction will allow the mission of the agency to be fully implemented.

IV. PERSONNEL

A. The Leadership

As has been previously presented in supplemental reports to the Transition Team, the Chairman of the Securities and Exchange Commission is going to resign as a Commissioner, if he is not permitted to serve as Chairman in the Reagan administration.

It is the recommendation of the Transition Team that Chairman Harold Williams be replaced on or before March 1, 1981 by a Chairman of the SEC, appointed by President Reagan. Recommendations have been made separately by the team concerning the characteristics of and individuals who might serve in this post. In addition, it is recommended that in June of 1981 when the seat of Commissioner Steven Friedman becomes available, that appointment be used by the Reagan administration to insure voting control by the Chairman appointed by this administration.

At the present time, it is possible that voting control can be achieved by a new Chairman with the assistance of presently sitting Commissioners Loomis, Evans and Thomas. However, the seat presently occupied by Commissioner Friedman is essential to insuring broader control over policy as well as personnel decisions.

B. The Staff

At the present time, the leadership of the staff of the Securities and Exchange Commission has been appointed by Chairman Williams or has remained from previous Democratic administrations. In virtually every area the leadership of the various divisions is unsatisfactory either because of philosophic incompatabilities or competence. The individuals occupying the leading staff positions have almost to a person been placed in noncareer senior executive staff positions.

Therefore, the new Chairman should make sweeping changes in senior staff promptly.

V. OTHER MATTERS

While legislative issues exist and other matters of some importance are treated in this report, these issues do not warrant early attention or treatment in this summary.

Historical Background and Overview

The Securities and Exchange Commission was created in response to securities problems associated with the stock market crash of the late 1920s and early 1930s. The 1933 Securities Act and the 1934 Securities Exchange Act were passed to ensure that the securities investor be provided with adequate disclosure information and be protected from the acts of unscrupulous individuals and firms.

Since 1934 the Commission has shifted physically, seen its budget expand and shrink, been given added responsibilities in conjunction with the 1935 Public Utility Holding Company Act, 1939 Trust Indenture Act, 1940 Investment Company Act and the 1940 Investment Advisers Act. During that time, it has become known as an agency which is tightly run, attorney oriented, a vigorous enforcer of esoteric securities laws, and a jealous guardian of its reputation as a highly independent agency.

It has been involved in considerable controversy over the past decade, owing to its role in the Foreign Corrupt Practices Act, in corporate accountability, in the deregulation--or elimination--of fixed brokerage commission rates, in implementation of the 1975 Amendments to the Securities Acts, principally concerning development of a national market system, and in its moratorium on the growth of the option markets.

Some critics of the Commission often contend that it should require more information in the way of disclosure, such as

the likely impact of environmental changes on corporate activities or the disclosure of corporate political contributions. Other critics contend that the market itself would assure the correct degree of corporate disclosure, if the SEC were to withdraw totally from the federal field. These critics assert that only fraud statutes (administered perhaps by the Department of Justice), investor protection (administered by SIPC); and disclosure-oriented self-regulatory organizations (such as the NASD and NYSE) need be in place to provide the investing public perhaps 95% of the protection it already enjoys. Because radical movements in either direction are unlikely in the forseeable future, this report assesses the SEC in its current environment, describing specific ways in which cost savings can be enjoyed without harm to the securities investor. It focuses on cost efficient regulation and provides recommendations regarding personnel, budgets, policy issues and legislative activities consistent with that objective.

In comparison with numerous oversized Washington bureaucracies, the SEC, with its 1981 requested budget of $77.2 million, its 2,105 employees and its deserved reputation for integrity and efficiency, appears to be a model government agency. The SEC is, in fact, several agencies in one. It directly influences the activities of a particular industry, the securities industry, in a fashion similar to the influence exercised over specific industries by such agencies as the CAB, ICC, and DOE.

In addition, the SEC influences more indirectly the activities of firms across industry sectors through, among other things, its corporate disclosure requirements. In this regard it is similar to the EPA, OSHA, EEOC and CPSC, which affect firms in virtually every industry. Also, the SEC maintains a strong enforcement program with detection and litigation responsibilities, which in a limited sense, could be compared with the influence of such governmental bodies as the Department of Justice and the IRS.

Because of the complex nature of the Commission's duties and the esoteric character of the securities laws, it is not clear that close scrutiny has been given the Commission and its evolving activities in recent years. The Commission, for example, has sought to expand its oversight responsibilities in many directions, to include commodity concerns, financial futures, pensions, and certain aspects of the banking industry. In so doing, it has ventured across regulatory boundaries, at times in cooperation with other agencies and at times in opposition to the views of other agencies. In an era of homogenization of financial industries, direction must be given to those agencies which find themselves in competition for regulatory jurisdiction in order to eliminate overlapping, duplicative requirements.

The SEC has begun to eliminate certain of its more burdensome regulatory requirements in recent years. It has taken positive steps to cut trading costs, has integrated to some limited extent 1933 and 1934 Act filings, and has

withdrawn some of its regulatory requirements pertinent to investment companies and venture capital firms. Its panoply of actions directed toward relief of small businesses may have contributed to the recent increase in securities issuance among small and medium-sized firms.

The Commission, however, could have moved at a much faster pace and more broadly to achieve more significant deregulation gains without compromising investor protection principles. Moreover, the Commission does not propose to moderate its own resource request currently or in the foreseeable future. There occurred a peak of activity at the Commission in the years immediately following the passage of the 1975 Securities Acts Amendments. These Amendments mandated new studies, new directions, and additional staff responsibilities. Since that time, the Commission has moved toward a posture of project monitoring and regulatory retrenchment. Moreover, fresh inititives requiring substantial budget allocations, such as the computerized surveillance system (uniformly opposed by SROs and others as duplicative of existing facilities) appear misplaced.

Thus, this Report closely surveys the current posture and plans of the Commission with an eye toward highlighting misplaced priorities and toward achievement of further deregulatory gains. These issues are addressed in the context of personnel, budget, legislative and policy actions which can be taken to enhance achievement of this agency's basic mission.

II. POLICY AND PROGRAMS REVIEW AND ANALYSIS

A. DIVISION OF MARKET REGULATION

Summary

This division is responsible for regulation of trading in securities markets in accordance with the provisions of the Securities Exchange Act of 1934. The division's current functions include oversight of securities markets and self-regulatory organizations (SRO's) regulation of securities professionals and inspection and examination of broker-dealers and transfer agents.

Pursuant to the 1975 Securities Act Amendments the division is responsible for facilitating the development of a National Market System. The staff seeks to serve as a catalyst for effective joint efforts in this regard. The divisions staffing has swollen greatly during the past five years; partially in response to the responsibilities with respect to the National Market System.

Recommendations

1. Cut the headquarters staff to not more than 50 persons from the present 130 positions. Diversify the staffing to provide more economists and market specialists to assist in the deregulation effort.

2. Re-focus the division's functions with emphasis on its primary statutory mission.

Three-Year Budget Projections*

FY 1981		FY 1982		FY 1983	
Positions	Cost	Positions	Cost	Positions**	Cos
237	$7,286	190	$5,828	152	$4,9

*Dollars expressed in thousands.

**Not more than fifty at headquarters.

Mission

The primary mission of the Division of Market Regulation is to maintain honest, fair and efficient securities markets. This Division's overriding objective is to regulate trading in the securities markets nationwide in accordance with the provisions of the SEcurities Exchange Act of 1934. It is assisted by the regional offices and support services.

Organization and Key Personnel

This Division is headed by a Director, who is assisted by a Deputy Director, a Chief Counsel and approximately nineteen senior staff of the Division. Market regulation is divided into three operating offices whose jurisdiction and activities substantially overlap. These offices are:

1. Office of Self-Regulatory Oversight;
2. Office of Inspections, Examinations and Surveillance;
3. Office of Financial Responsibility and Securities.

Each of these offices is administered by an Associate Director assisted by two or three Assistant Directors.

Budget

The estimated budget for the 1981 fiscal year is $12,457,000.00. This represents an increase of 23.3% from the budget estimate for fiscal year 1980. As indicated by the table below, only a small portion of this increase is

attributable to salaries and other personnel-related costs. SEC Market Regulation 1981 Budget Comparison Figures. 1/

	FY-1979 Actual		FY-1980 Actual		FY-1981 Actual	
Organizations	Staff Years	Cost (000)	Staff Years	Cost (000)	Staff Years	Cost (000
Market Regulation	124.2		139.0		138.4	
Reports & Information Services	17.7		17.7		17.7	
Regional Offices	112.1		124.9		124.9	
Sub-Total Salaries	254.0	$6,137	281.6	$7,116	281.0	$7,3
Personnel Benefits		576		670		6
Travel		254		241		2
Other Expenses		2,070		2,074		4,2
Total Program Cost		$9,037		$10,101		$12,4

Discussion

Prior to the 1975 Act amendments, the Division's mission was carried out by a staff of approximately twenty-five persons. While there was ample justification for some expansion in the Division during the period in which the Commission had responsibilities for implementing the 1975 Act Amendments, such expansion greatly exceeded any identifiable needs. Furthermore there has been no reduction in staffing, despite the relatively modest activities presently being carried out by the Division.

1/ SEC Budget Estimate Fiscal 1981, at 48.

The jurisdiction and activities of each of the three operating offices within the Division greatly overlap. Due to a lack of new think-tank projects, the Division has reshaped its mission to be one of "oversight." This oversight function extends to reviewing proposals by self-regulatory organizations (SRO's) concerning proposed rule changes and the oversight of the actual execution of self-regulatory compliance and enforcement programs.

These oversight activities have been carried on at a level which is both unnecessary and highly undesirable. The most significant criticism concerning these oversight activities is that the division concentrates on minor insignificant detail in its "oversight" activities. At the same time, the Division is criticized for the rather significant time delays which occurred in the so-called "review" of regulatory proposals submitted in the form of rule changes by the self-regulatory organizations.

Excessive delay seems to be a recurring problem in much of the Division's activities. Major policy issues within the Division have not yet been addressed, although they have been under consideration for some time. For example, issues with respect to options trading have been pending for several years during which time the Commission imposed a moratorium in the options trading area. Despite the lifting of that moratorium, the Commission's staff has yet to come to grips with these policy issues. Other subjects which have experienced long delays include reciprocal trading rules proposed by

self-regulatory organizations and underwriter compensation for new issues, which have been lingering for years without any final action by the staff.

Despite these seemingly inordinate delays in processing major policy issues, the Division deploys more than 50 of its 130 staff members on trips throughout the country visiting fourteen NASD offices, six regional exchanges and the New York and American Stock Exchanges. These staffers are often ill-trained and poorly equipped to evaluate in a meaningful way the programatic activities of these self-regulatory organizations. They concentrate on the insignificant and the trivial and cause needless expenditures of government funds and self-regulatory organization funds in pursuing issues which have little relevance or importance to investor protection.

The primary mission of this Division should be serving as a "think-tank" for regulatory reforms which might deregulate the securities industry. At the present time, the staff appears timid in continuing with regulatory reform efforts. Rather, the Division is content to permit a status quo which locks in certain undesirable franchises in the options trading area; proceeds slowly with respect to the desirable deregulation by evolution of a National Market System; and appears totally unwilling to recognize the realities of the out-moded uniform net capital rule which bears little, if any, relationship to the realities of day-to-day activities of major financial institutions in dealing with diverse products. Further discussion of each of the

major policy issues facing the Division is contained in the Policy Issues subheading in this section.

Options

A preliminary analysis of the Division of Market Regulation indicates that the present staffing level of 130 persons represents a significant overstaffing in light of the relatively modest activities for which the Division is presently responsible. Certainly this staffing level cannot be justified based upon the Division's primary mission. Serious consideration should be given to substantially curtailing the "oversight" activities of the Division.

It appears unlikely that the legitimate functions of the Division requires a staff of greater than fifty persons. This staff would contain a small unit devoted to serving as a catalyst for changes in the National Market System, another small unit devoted to evaluating at a high-management level the performance of the self-regulatory organizations, and a third small unit dealing with financial and back office activities such as clearing corporations, transfer agents, depositories, and securities processing activities in the brokerage community. ~~It would also seem~~ advisable to attempt to diversify the types of personnel staffing within the Division to include economists and market specialists to assist in the primary objective of responsible deregulation of the securities industry. Significant cutbacks in the Division's staffing level seem warranted in order to return the Division the proper operating posture. Of course, an alternative option would be to make no changes.

Recommendations: See Summary items One and Two.

Policy Issues

The National Market System

Summation

Pursuant to the Securities Act Amendments of 1975 the Commission was directed to facilitate the establishment of a National Market System for Securities. Previously the Commission has served as a catalyst for constructive change in this area. Responsible progress towards the development of a National Market System is a desirable objective. The current Commission's study pursuant to Rule 19c-3 should provide useful data concerning an orderly transition to a National Market System.

Relevant Statutes

Securities Acts Amendments of 1975 1/ established as a purpose of the Exchange Act "to remove impediments to and perfect the mechanism, of a national market system for securities". The Amendments further directed the Commission to "facilitate the establishment" of this National Market System. 2/ Activities in furtherance of this directive have been undertaken by the Commission pursuant to sections 11A, 17A, and 19 of the Exchange Act. Rulemaking activity has been undertaken by the Commission for the purpose of facilitating incremental steps towards the development of a National Market System.

1/ Pub. L. No. 94-29 (June 4, 1975).

2/ Section 11A(a) (2) of the Exchange Act, 15 U.S.C. §78k-1(a)(2).

Sub-Issues

(a) Rule 19c-3

Discussion

Exchange rules on each of the national and regional stock exchanges require customer orders to be executed by exchange members on the exchange floor. These rules are designed to assure greater market depth in the various stock traded on a particular exchange.

On April 26, 1979, the SEC proposed Rule 19c-3 which essentially permits exchange members to trade certain securities other than on the exchange floor. Principally, it permits wire houses and other large dealers and securities to make in-house trades based upon the customer orders which they have received. Also regional broker dealers in the over-the-counter market are also able to make an off the exchange market in these securities.

As adopted, this rule applies only to securities which were listed on an exchange after April 26, 1979. Presently approximately 40 securities are traded on this basis. The SEC is studying the evolution of this system and its impact upon market and a more competitive market. Principally the Commission is attempting to assess the effect of permitting major brokerage firms to make an independent market in competition with the exchange specialist for a particular stock.

Options

Possible options in this are include: (1) withdrawal of Rule 19c-3; (2) continued study of the effects of Rule

19c-3 upon that limited class of securities to which it applies; (3) expansion of the coverage of Rule 19c-3 to permit off-market trading in a majority of or all securities presently traded on regional exchanges; (4) some other modification of Rule 19c-3.

Recommendations: Continue study with a view to prompt expansion.

(b) Cincinnati Experiment and Inter-Market Trading System

Discussion

The term "Cincinnati Experiment" refers to an automated computer trading system now in operation on the Cincinnati Regional Stock Exchange. Initial commission approval for this trading system was given in April of 1978. At this time the system has been in operation for approximately two and a half years.

Essentially this automated system consists of a computer listing of all limit orders which have been placed with members of the Cincinnati Exchange. Orders are matched on a strict best price and time priority. Contrary to normal procedures no size precedence is given. This system essentially eliminates the phenomenon as sizing out, whereby small sell orders are not matched with larger buy orders. This totally automated system not only automatically matches customer orders based on a strict best price and time priority but also issues automatic reports on execution of the order. The system is presently operated by Control Data.

Currently a substantial issue exists with respect to linkage of this system into the regional securities marketing

system. Particularly the Commission is concerned with the most effective method of interfacing this system with the intermarket trading system (ITS) which is in use on the floor of various regional and national exchanges. ITS is essentially a communications system which links six stock exchanges nationwide, the New York Stock Exchange, the American Stock Exchange, the Philadelphia Stock Exchange, the Boston Stock Exchange, the Midwest Stock Exchange, and the Pacific Stock Exchange. Through this system a specialist on the Pacific Exchange can obtain the available quotes on a particular stock from all six exchanges and theoretically execute an order against the best available price with a response confirming the transaction received on the floor of the Pacific Exchange. In theory this provides for a more competitive market based upon a better availability of market information.

At present there are no fees for using the ITS system. However, obtaining a response for transactions using ITS system may require up to several minutes of the broker's time. As a result a broker may not use the ITS system even though a slightly better "up to a quarter of a point" is available in another market. This may also happen where the better quote does not represent sufficient shares to satisfy the customer order which is to be executed, i.e. the customer order is for 1,000 shares and the better quote available on the Pacific Exchange is only 100 shares.

Unlike the automated Cincinnati system the ITS

system does not work an automatic execution. The broker must await an acceptance from the exchange in question which can require several minutes of lag time. However, the availability of this system does permit the broker to call up quotes from all securities markets. In certain cases the availability of this consolidated quote will allow the investor to obtain a better deal than was otherwise available on the New York Stock Exchange.

In this area the SEC has adopted Rule 11Ac1-2 which essentially requires broker dealers to make available on CRT terminals consolidated best bid and offer quotes. Due to the necessity of developing the requisite technology which is supplied us information the effective date of this rule had been established as September 1, 1981. Adoption of this rule embodies a Commission judgment that the availability of the consolidated quote will foster a more competitive securities markets by providing investors with access to markets that they might not otherwise have known about.

Options

At the present time the Commission is pursuing issues relating to the integration of the Cincinnati Experiment and the intermarket trading system. Presently the SEC has taken a rather cautious posture which seems to encourage the development of additional order flow for a Cincinnati-type system based on automatic size and time priority execution. The possible options

with respect to the integration of these two systems are: (1) gradual development of a Cincinnati-type system on the floor of each of the various national and regional exchanges; (2) development of better communications system along the lines of the present ITS system which would link all of the regional and national exchanges; (3) development of some hybrid model based upon the best features of the Cincinnati system and the broader availability of the ITS system.

Recommendations

The integration of these alternative systems is a desirable goal, but it should not supercede the effort to explore other alternatives to a better flow of market information and market trading. The effect of the automatic matching features of the Cincinnati system market merit further evaluation.

(c) Qualified Securities

Discussion

Pursuant to the plan to develop a national market system the Commission has undertaken to designate particular securities as "qualified securities". On June 15, 1979, the Commission proposed Rule 11Aa2-1. The principal effect of this rule if adopted would be that a limited number of stocks presently traded in the over-the-counter market may be put on tape as a sort of last sale reporting device.

Options

1. Define qualified securities now.

2. Wait for linkage of ITS and execution capability, then define qualified securities to include OTC securities.

Recommendations

The Commission's rule in this area should be reconciled with the overall deregulatory effort. Option two as discussed above is most consistent with these goals.

(d) Limit Order File

Discussion

The Commission has proposed a rule to require nationalwide investor price protection. Currently it is possible that an investor placing a limit order on the Midwest Stock Exchange may be bypassed by New York Stock Exchange trade at lower price. Presently there is no uniformity with respect to the type of protection which is provided against this phenomenon. One such protection is the so-called "price penetration" which is triggered only when a trade below the price of the limit order placed on the regional exchange occurs on the New York Stock Exchange. The so-called "on volume" triggering mechanism requires that a trade of a volume equal to or more than the shares specified in the limit order be traded at the limit order price.

Proposed Rule 11Ac1-3 which was promulgated on April 26, 1979, would require that an order at a price inferior to a limit order could not be executed if the security was presently being traded through the inter-market trading system (ITS). This rule was designed to protect the seller from receiving an inferior price where a better deal was available through a public limit order. The Commission has taken the view that such increased intermarket price protection for sellers of

securities is a desireable market phenomenon.

In response to the SEC's concerns, the securities industry has proposed as an alternative to the SEC's proposed rule, a computer limit order information system (L.O.I.S.). Using this L.O.I.S. system the market specialist will enter summaries of all public limit orders which he holds into computer storage terminals. The broker with a customer order away from the market price would check the limit order information system (L.O.I.S.) and execute against any available orders listed in this system first.

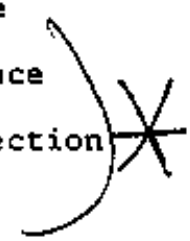
Presently industry sources indicate that a pilot L.O.I.S. project should be operational some time before June 1981. Discussions are still being held with respect to the practical mechanism involved in this system. The Commission intends to monitor this pilot project and assess its effectiveness.

Options

The options in this area include: (1) adoption of Rule 11Ac1-3 as originally proposed; (2) adoption of a modified version of Rule 11Ac1-3 to provide some measure of increased intermarket price protection to sellers of securities; (3) withdrawal of Rule 11Ac1-3 with reliance instead upon a L.O.I.S. type system to provide an increased measure of intermarket price protection; or (4) continuation of the present status quo with regard to intermarket price protection based upon triggering mechanisms such as the "price pene-

Recommendations

The industry supported L.O.I.S. project deserves a thorough evaluation. Adoption of Rule 11Ac1-3 seems inwise when the Commission is attempting to deregulate. Indeed, the evidence as to whether any type of increased intermarket price protection can be cost justified is not compelling.



Options Markets and Trading

Summation

Major policy issues confront the Division concerning options trading activity. These issues generally relate to the appropriate market structure for options trading. At the present time the Commission has by policy required, subject to very limited exceptions, options listed securities be traded only on a single exchange market and has prohibited the same exchange from trading both options in securities and the underlying security.

Relevant Statutes

The Commission possesses delegated authority regarding options trading pursuant to Section 9 of the 1934 Exchange Act. General regulatory powers under Section 19(b) are also utilized in connection with the regulation of options trading on regional and national exchanges. The Division's activity in this area has largely been accomplished without reliance upon formal rules promulgated pursuant to §9.

Sub-Issues

(a) Multiple Listing of Securities Options

Discussion

The Division is charged with the responsibility of

approving applications for options trading filed by various national regional exchange markets. In this role the Commission has adopted a policy which effectively prohibits the trading of securities options on more than one exchange market, subject to very limited exceptions. This policy effectively creates a monopoly franchise in the options on a particular security. The Division's creation of such franchises for options trading in a particular security is a highly questionable policy choice which appears to greatly diminish trading of securities options.

Options

It would seem that a prompt reassessment of the Division's informal policy in this regard is in order. Relaxation of this informal policy against multiple listing of securities options deserves careful consideration. The possible alternatives range from totally abandoning this policy to relegating it to one factor to be considered in reviewing applications. While the present policy could be retained, the notion of granting monopoly franchises for options in a particular security seems inconsistent with fostering a competitive and efficient options trading market. Alternatives to the Division's present hardline policy in this area should receive consideration.

Recommendations

Discard the present hardline policy on this issue, in order to encourage the development of integrated and competitive options trading markets.

(b) Integrated Trading of Options and Underlying Stock

Discussion

As discussed previously has responsibility for approving applications for options trading. An informal policy has been developed and applied in this area which effectively prohibits a single exchange from trading both options and the underlying security. The Division continues to apply this informal policy rather than coming to grips with the underlying policy issues concerning the trading of options and the underlying security on the same exchange.

Options

A number of alternatives with respect to these issues are available. Resolutions of these issues may be sought either through continuation of an informal policy applied to applications or options trading or by some more formal policy declaration. In any event reassessment of the practical effect and necessity of the presently applied policy seems warranted. Such an undertaking should likely include some input from the options trading community. Possibly a more flexible approach in this area will encourage and foster the capital formation process.

Recommendations

Adopt a more flexible approach to this issue as part of an overall effort to develop a competitive options trading market and more importantly a sound securities market. The concerns for potential manipulation should be given great attention as deregulation occurs.

Broker Dealer Financial Regulation: Net Capital Rule and FOCUS

Discussion

Presently the Commission is considering changes to both the Uniform Net Capital Rule and the FOCUS Report as applicable

to broker dealers. The "net capital" rules were adopted by the Commission pursuant to authority under Section 15(c)(3) of the Exchange Act. Under the terms of the net capital rule, Rule 15c3-1, a broker dealer must maintain certain minimum "net capital".

The FOCUS report was created as a deregulation effort approximately four years ago. As presently constituted the report requires broker dealers to periodically submit certain financial and operational information concerning their financial condition and securities trading activities.

Options

The Commission is presently soliciting comments upon proposed changes in Uniform Net Capital Rule as suggested by the Securities Industyr Assocaition. These changes relate to the broker dealer financial responsibility requirements contained in the present net capital rule. Obviously, these changes should be carefully evaluated by the Commission. However, a larger issue looms on the horizon. Continuing changes in the securities markets and in the financial institutions which comprise those markets raises an issue concerning whether the net capital rule, customer segregation rule, and related recordkeeping requirements have applicability and utility in their present form. This underlying issue requires prompt in depth examination to reassess the value of these costly regulatory requirements. A simplified net capital rule and a more relevant customer segregation would be desirable.

The Commission is also presently proposing to modify the number and type of reportable items required on the FOCUS report. Careful consideration should be given as to whether any additional reporting burdens can be justified before any changes to the FOCUS report are adopted. Modernization and elimination of reporting requirements is a highly desirable goal. Additional reporting burdens should be adopted only if there is a clearly demonstrated need for the information. On the other hand, elimination of unnecessary and unessential reporting requirements should be actively pursued and consistent with the policy of effective deregulation.

Recommendations

Based on our evaluation the present financial regulation of broker-dealers is out of touch with present market realities. The present net capital rule should be abandoned and replaced by a less comprehensive measure of financial soundness. The FOCUS Report requirements should not be expanded, absent a compelling need for the information. In short this area merits a total revision of the regulatory mechanisms now in use.

Papilsky Problem and Fixed Price Security Offerings

Discussion

The policy issues raised in Papilsky v. Berndt have been exposed to public comment by the Commission on four separate occasions. These issues have also been the subject of extensive public hearings. These issues relate to practices in connection with fixed price offerings or so-called "underwriting practices". Present proposal is undertaken in accordance with authority pursuant ot Section 19(b)(1) of the Securities

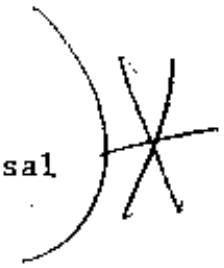
Exchange Act of 1934.

Options

The presently proposed solution to these issues appears to have the consensus support of the entire industry as well as the Commission itself. Since these issues have been under consideration for some time there appears to be no justification for further delay in adopting the present proposal. Resolution of these issues promptly is desirable in order that capital formation may be encouraged and facilitated.

Recommendations

Resolve these issues by adopting the present proposal immediately.



ENF

B. DIVISION OF ENFORCEMENT

Summary

This division has enforcement responsibilities under all the federal securities laws. The division both investigates possible violations and institutes administrative, civil or criminal action when appropriate. Under the present model this division operates in a centralized fashion. Previously the regional offices had greater enforcement responsibility.

Recommendations

1. Reduce the central office staff to not more than fifty by end of Fiscal 1983. Permit the regional offices to assume more of the workload and decision making.

2. Shift the enforcement emphasis to major matters more closely related to statutory objectives.

3. Spend less time on prolonged investigations.

4. Reduce the reliance upon consent injunctions to resolve major enforcement cases.

Three-Year Budget Projections*

FY 1981		FY 1982		FY 1983	
Position	Cost	Position	Cost	Position	Cost
597	$19,765	507	$16,801	431	$14,064

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* Dollar figures expressed in thousands

** Not more than fifty staff positions in central office by June 1982.

Mission

The primary goal of the Division of Enforcement is to preserve the integrity of the securities markets through enforcement of the various federal securities laws. This objective is pursued through investigating significant indications of the possible violations, and by instituting and participating in administrative, civil and criminal actions against broker dealers, investment advisors, investment companies, transfer agents, issuers of securities, corporate officials, promoters, members of organized crime and others, who violate the federal securities laws, including the Securities Act of 1933, the Securities Exchange Act of 1934, the Public Utilities Holding Company Act of 1935, the Trust Indentures Act of 1939, the Investment Company Act of 1940, and the Investment Advisors Act of 1940.

Organization and Key Personnel

The Division of Enforcement has in excess of 200 staff positions located in the Washington, D. C. central office. Approximately 500 additional personnel are deployed in the nine regional offices to carry on the same enforcement functions. The estimated total cost of this program is $26,885,000.00 for FY 1981 an increase of $652,000.00 from FY 1980. These staffing levels are consistent with those actually maintained in fiscal years 1979 and 1980. Prior to 1972, enforcement activities were not concentrated in a single division but were located in each major policy division, i.e, Corporation Finance, Market Regulation and Investment Management. At that time, primary enforcement responsibility was less centralized with a larger role being exerted by the nine regional offices.

Under an earlier organizational model enforcement activity was carried on primarily, and virtually exclusively, by the regional offices.

The key personnel consist of the Director, two Special Counsels, five Associate Directors, five Assistant Directors, two Chief Trail Attorneys, a Chief Enforcement Accountant, a Chief Counsel, and also numerous branch chiefs.

Budget

The estimated budget for FY 1981 is in excess of twenty-six million dollars, approximately two-thirds of which is attributable to personnel costs. Roughly three-quarters of these resources are consumed by enforcement activities of 500 persons in the regional offices. Detailed budget data is provided in the Schedules attached to the Budget.

Discussion

The integrity, deducation and zeal of the staff of the SEC's Enforcement Division is the envy of government. What follows is a constructive critical analysis of ways to strengthen and improve this fine effort in the context of changing conditions and changing markets.

It is widely recognized that the Division of Enforcement benefits from highly-trained professionals, good leadership and a dedication to the principles of integrity. Nevertheless there are members of both the legal community and the corporate community, including brokerage firms and public companies who feel that improvements can and should be made. A number of these individuals who are highly respected, while praising the Division, have felt it necessary to make constructively critical comments in a number of areas. These comments are synthesized below:

1. There are too many cases of too little significance which are costly to everyone. These cases gain little for the agency or its policy goals.

2. The staff will not terminate a case without "some action" even if such termination is warranted.

3. On occasion, the young staff, principally in the headquarters office, is overly zealous, at times it lacks professionalism, and is not carefully supervised. It appears that the goals being sought in certain circumstances are a public display of results rather than sound enforcement objectives.

4. The lines of responsibility within the agency are not clear on all enforcement matters. The headquarters office and certain regional offices appear to compete for jurisdiction over cases.

5. The major decisions on how to resolve enforcement cases require endless rounds of discussion at the regional office level, only to be followed by additional

rounds of discussion at headquarters. The positions of the Commission's two offices are often in conflict and result in changes in "agreements" previously made. This causes the public to have a diminished confidence in the objectivity of the Commission's enforcement and tends to give the impression of a "personalized" enforcement effort. Also, it tends to weaken the role of the regional office in the Commission's enforcement program, notwithstanding that the regional office enforcement effort comprises overall more than 70% of the Commission's enforcement effort.

The SEC's Enforcement Division as a Government Resource

Notwithstanding specific constructive criticisms which have been made as to the particular model for the delivery of enforcement being used at the SEC, it is widely recognized that the trained professionals at the SEC are a valuable government resource. At least five of the modern time senior staffers are presently spread throughout different government agencies where their work is enhancing the overall programmatic activities of the DFTC, FERC, GSA, DOE, and various bank regulatory organizations as well as others.

The technique of investigation and litigation and the enthusiasm which the staffers of the SEC bring to their work is truly a model for all of government. In any discussion of a reorganization or realignment of the enforcement effort at the SEC, it must be noted that the system which presently exists is a valuable system.

However, the strength of the system has been that the Commission is willing to continue to innovate. As recently as eight years ago there was a complete new realignment and centralization of enforcement responsibilities at headquarters. In the immediately preceding seven years there was a different model of enforcement which was dispersed throughout divisions. Prior to that, while the SEC enforcements effort was still thought to be excellent, the principal enforcement activity was carried out in the regional offices. It is not clear whether the Commission's well-deserved reputation for excellence is based upon a particular system for the delivery of enforcement or whether the Commission's tradition of excellence in enforcement is attributed to its ability to hire and motivate highly-skilled professionals, who under the leadership of a trained corps of dedicated managers grow into the needs of the marketplace during the relevant periods of time.

The Division of Enforcement is often criticized because it agrees to resolve fairly major cases solely on the basis of a "consent" to a permanent injunction. This criticism is levelled based on the perception that cases of this magnitude should legitimately require a much

stronger penalty. At the same time, others have criticized Division of Enforcement for what has been characterized as "irresponsible" subpoena and investigative techniques. The Division is sometimes characterized as a headline-seeking prima donna without significant commitment to important enforcement objectives.

A substantial policy issue exists concerning whether the program objectives and overall mission of the Commission might be more effectively carried out by use of a different model for the overall enforcement program. The present centralized bureaucracy which overlays all enforcement activities in the regional offices often leads to needless and duplicative reassessment and reevaluation concerning matters under investigation or consideration for action.

Historically, regional office enforcement programs have been the origin point for virtually every major enforcement matter. The regional offices through their relationships of the National Association of Securities Dealers District Offices and regional and national stock exchanges are in a position to carry out in an effective and efficient manner most normal enforcement policies. During the period immediately prior to the late 1960's the Commission's enforcement activities were carried on in a satisfactory fashion through almost exclusive use of the regional offices.

The benefits of the enforcement program are generally maximized when enforcement activity identifies conventional investor protection violations, e.g., insider trading or classic forms of fraud and manipulation. In those instances where significant violations directly related to the statutory objectives of investor protection are uncovered they should be properly pursued to civil and criminal dispositions. Less desirable unfocused broad ranging investigations should be curtailed whenever possible. What should be avoided is the needless proliferation of enforcement investigations by informal means or by formal subpoenas which result in years of staff time being expended with the net result of a meaningless array of consent injunctions which have little, if any, significance to the investing public or to the individuals involved in the matter.

A substantial reduction in resources might be achieved through such a redirection of the enforcement activitives toward goals more closely related with the basic investor protection issues.

A related issue is the policy of disclosing publicly the countless and at times insignificant enforcement actions. This practice may be precisely counterproductive to the overall mission of insuring investor confidence. The banking community model of enforcement without publicity may be more desirable at this time and should be considered at least in part in certain types of cases.

Options

1. A range of policy options confront the new administration concerning the proper staffing and proper role of the Division of Enforcement. One available option is to leave the staffing and enforcement responsibilities undisturbed such that the Division of Enforcement would continue to operate in a centralized manner utilizing approximately 200 staffers in the central office to review, reassess and "direct" the ongoing investigations and other enforcement activities conducted by the regional offices.

2. An alternative approach is to decentralize the enforcement effort by shifting the emphasis and workload of the enforcement effort to the regional offices. By supplementing the enforcement activities of the regional offices with a small highly specialized team of Enforcement Division personnel in Washington, D. C., not to exceed total of fifty, the SEC could relieve much of the potential for duplication and conflict inherent in the present system. Under this system the role of the Division would be confined policy assistance for significant cases which either presented new and emerging policy issues or represented emergency dangers to the market place. Under this model total responsibility for routine enforcement activities would rest in the appropriate regional office, with little or no review function in the Enforcement Division. In appropriate circumstances this smaller Division of Enforcement could also supply its manpower,

expertise, or other support services to major enforcement activities at the regional office level.

3. Another possible alternative is to eliminate the Division of Enforcement in Washington altogether and replace it with a coordinated regional enforcement program. Such a program would be similar to the enforcement system that was employed during the early and mid 1960's. Such a decentralized approach to enforcement would provide each regional office with an opportunity to evaluate those situations which merited enforcement attention. Based on their closer working relationships with broker dealers and the securities community generally these individuals are in a position to administer enforcement policies in an effective manner. However, the utility of this total decentralized approach is dependent upon the sufficient level of coordination between the regional offices.

Significant policy choices concerning case selection and prosecution must be made, independent of which the three delivery models is adopted. Presently there seems to be an over-utilization of the consent injunction as a technique for resolving enforcement cases. Concentration on fewer and more significant cases may present a more effective enforcement strategy. If the technique of accepting consent injunctions was utilized less frequently more significant attention could be devoted to areas of hardcore violation. In those cases more stringent criminal, civil and administrative remedies should be sought.

Recommendations

Decentralize the enforcement effort with substantial personnel cuts at Washington, D. C. Office. Reduce Washington staff to not more than 50 by end of Fiscal 1983. Shift enforcement responsibility to regional offices.

Redefine enforcement objectives and select cases based on the major statutory principles e.g. insider trading, etc. Deemphasize the use of consent injunctions in enforcement cases. Discontinue the policy of publicly disclosing the countless investigations which are commenced annually.

GC

C. OFFICE OF GENERAL COUNSEL

Summary

The General Counsel fulfills an important role as legal adviser to the Commission on matters outside the expertise of the policy divisions. The General Counsel also has responsibility for appellate litigation.

Currently there are approximately 108 positions requested for fiscal 1981, approximately the same as 1980.

Policy units within the General Counsel's Office deal on a concurrent basis with every memorandum prepared for the Commission's consideration by the legal staff maintained by the various substantive divisions. More than 20 persons are employed on a full-time basis to provide this duplicative and apparently unnecessary function.

Similarly the wisdom of maintaining a separate unit, employing 20 persons devoted to actively reviewing civil litigation in all circuits and district courts which involves the various securities acts is suspect. The mission of this unit is to actively search for business by evaluating cases in which the Commission may wish to serve as amicus in either district court or court of appeals litigation.

Three-Year Budget Projections*

FY 1981		FY 1982		FY 1983	
Positions	Cost	Positions	Cost	Positions	Cost
90	$3,078	60	$2,020	38	$1,29

* Dollar figures e pressed in thousands.

Mission

The General Counsel is the chief legal officer of the Commission. The traditional functions of the General Counsel entail providing general legal advice to the Commission concerning legislation and a broad range of other issues including defense of the Commission in litigation where necessary. In addition, the General Counsel's office has traditionally had responsibility for handling all appellate litigation arising out of the Commission's enforcement work and reviews all cases where criminal prosecution is recommended.

Organization and Key Personnel

At the present time approximately 108 individuals are assigned to staff the Office of the General Counsel. An additional 30 staff are employed in the nine regional offices to fulfill the same functions. As recently as the early 1970's this Office required less than 20 persons to fulfill its traditional functions. Each of the Commission's substantive divisions, including Corporate Finance, Market Regulation, Investment Management, Corporate Regulation and Enforcement maintain their own staff of highly trained legal personnel. However, recently a duplicative legal evaluation and policy unit within the Office of the General Counsel has been established to deal concurrently with matters of legal policy. Currently more than 20 individuals are engaged in this function.

The Office is headed by one General Counsel who is assisted by a Solicitor and three Associate General Counsels. Key personnel also include eight Assistant General Counsels and an Ethics Counsel.

Budget

The Commission's FY 1981 budget estimates include approximately $5.7 million for legal services. Approximately $3.6 million is attributable to staff salaries. As compared to FY 1980 the total budget figures represent an increase of less than two percent.

Discussion

The Office of the General Counsel has experienced a substantial swelling in this personnel since 1975 and has assumed duties far beyond its traditional role. A preliminary evaluation reveals that many of these additional functions represent more government than is necessary and are of marginal utility. It must be remembered that each substantive division of the Commission maintains its own highly-skilled legal personnel fully knowledgeable concerning the Commission's policies and all legal issues relating to the mission of that Division. Notwithstanding this resevoir of legal expertise which exists in the various substantive divisions, a duplicative legal evaluation and policy unit for each substantive division is maintained with in the Office of the General Counsel.

These policy units within the General Counsel's Office deal on a concurrent basis with every memorandum prepared for the Commission's consideration by the legal staff maintained by the various substantive divisions. More than 20 persons are employed on a full-time basis to provide this duplicative and apparently unnecessary function.

Similarly the wisdom of maintaining a separate unit, employing 20 persons devoted to actively reviewing civil

litigation in all circuits and district courts which involves the various securities acts is suspect. The mission of this unit is to actively search for business by evaluating cases in which the Commission may wish to serve as amicus in either district court or court of appeals litigation. This expansive view of the Commission's responsibility of investor protection appears to be more government than is desireable and, if eliminated, could reduce by approximately 15 positions the budget and personnel requirements of the Office of General Counsel.

Another area in which the General Counsel appears to have assumed a predominant and perhaps unnecessary role is in the legislative sphere. Apparently, the General Counsel nothwithstanding the substantive expertise of the various divisions has determined to assume a supervisory role with respect to all legislation which may be of concern to the Commission, including the proposed Federal Securities Code. If the legislative role of the Office of the General Counsel were diminished or curtailed, especially with respect to issues within the expertise of one of the policy setting divisions, additional reductions in the personnel force could be implemented.

Options

As discussed in the previous section, certain reductions in the staffing level in the General Counsel's Office can be made without impairing its ability to perform its traditional functions. The available options are:

1. Eliminate all the additional duties which have been assumed by the General Counsel;

2. Eliminate or curtail some of the duplicative legal policy review functions;

3. Eliminate or drastically curtail the active review of all securities litigation;

4. Reduce or eliminate the General Counsel's predominate role concerning pending legislation.

The General Counsel's Office has an important role to fulfill in advising the Commission on matters not within the substantive expertise of the Commission's policymaking divisions and in handling appellate litigation for the Commission. Any mission beyond these basic functions appears to be duplicative and largely unnecessary. Elimination of any or all of these additional functions which have been assumed by the General Counsel's Office is consistent with the President-Elect's goals of less government and will not impair the Commission's overall mission and organizational structure.

Recommendations

Redefine the role of the Office of General Counsel along the traditional model. Eliminate duplicative legal evaluation and policy units within the Office. Redefine the role of the General Counsel to permit the other substantive divisions more flexibility to deal with legislative proposals which concern matters related to their expertise.

Reduce staffing to manpower levels commensurate with the new duties.