

**30th ANNUAL REPORT**  
**of the**  
**SECURITIES AND EXCHANGE COMMISSION**

**For the Fiscal Year Ended June 30, 1964**

SECURITIES AND EXCHANGE COMMISSION  
Headquarters Office  
425 Second Street NW.  
Washington, D.C. 20549

**COMMISSIONERS**

January 4, 1965

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

ORVAL L. DUBOIS, Secretary

LETTER OF TRANSMITTAL

SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

SIR : On behalf of the Securities and Exchange Commission, I have the honor to transmit to you the Thirtieth Annual Report of the Commission covering the fiscal year July 1, 1963 to June 30, 1964, in accordance with the provisions of Section 23 (b) of the Securities Exchange Act of 1934, approved June 6, 1934; Section 23 of the Public Utility Holding Company Act of 1935, approved August 26, 1935; Section 46 (a) of the Investment Company Act of 1940, approved August 22, 1940; Section 216 of the Investment Advisers Act of 1940, approved August 22, 1940; Section 3 of the Act of June 29, 1949, amending the Bretton Woods Agreement Act; and Section 11 (b) of the Inter-American Development Bank Act.

Respectfully,  
MANUEL F. COHEN,  
Chairman.

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

## **TABLE OF CONTENTS**

Commissioners and staff officers

Regional and branch offices

Biographies of Commissioners

### **PART I IMPORTANT DEVELOPMENTS DURING THE YEAR**

Special Study of Securities Markets and its implementation

Enforcement activity; proposed revision of annual report form for investment companies

Registration of new security offerings

### **PART II LEGISLATIVE ACTIVITIES**

### **PART III REVISION OF RULES, REGULATIONS AND FORMS**

The Securities Act of 1933

Adoption of Rule 156

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

The Securities Exchange Act of 1934

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

Adoption of Rule 11a-1

Amendment of Rule 14a-3

Amendment to Rules 13a-15 and 15d-15 and Form 7-K

Adoption of Rule 15c2-7

Adoption of Rule 15c3-2

Adoption of Rule 16b-9

Adoption of Rule 17a-8

Proposed Rule 17a-9

Proposed Amendments to Form 8-K

The Investment Company Act of 1940

Amendment of Rule 3c-3

Adoption of Rule 12d-1

Amendment of Rule 17a-6

Amendment of Rule 17g-1

Proposed Amendment of Rule 20a-2

#### **PART IV**

#### **ADMINISTRATION OF THE SECURITIES ACT OF 1933**

Description of the registration process

Registration statement and prospectus

Examination procedure

Time required to complete registration

Volume of securities registered

Registration statements filed

Stop order proceedings

Examinations and investigations

Exemption from registration of small-issues

Exempt offerings under Regulation A

Suspension of exemption

Exempt offerings under Regulation B

Exempt offerings under Regulation E

Exempt offerings under Regulation F

## **PART V**

### **ADMINISTRATION OF THE SECURITIES EXCHANGE ACT OF 1934**

Regulation of exchanges and exchange trading

Registration and exemption of exchanges

Exchange disciplinary action

Commission inspection of the exchanges

Registration of securities on exchanges

Statistics relating to registration of securities on exchanges

Number of issuers and securities

Market value of securities traded on exchanges

Share and dollar volume and market value of stocks traded, by fiscal year

Foreign stock on exchanges

Comparative exchange statistics

Delisting of securities from exchanges

Delisting proceedings under Section 19 (a)

Unlisted trading privileges on exchanges

Applications for unlisted trading privileges

Block distributions reported by exchanges

Over-the-counter statistics

Reporting under Section 15 (d)

Manipulation and stabilization

Manipulation

Stabilization

Insiders' security holdings and transactions

Ownership reports

Recovery of short-swing trading profits by issuer

Regulation of proxies

Scope of proxy regulation

Statistics relating to proxy statements

Stockholders' proposals

Ratio of soliciting to non-soliciting companies

Proxy contests

Investigations with respect to reporting provisions

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

Registration

Administrative proceedings

Revocation and denial proceedings

Decisions of particular interest

Suspension proceedings

Net capital rule

Financial statements

Broker-dealer inspections

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

NASD disciplinary actions

Commission review of NASD action on membership

Commission review of NASD disciplinary action

## **PART VI**

### **ADMINISTRATION OF THE PUBLIC UTILITY HOLDING COMPANY ACT OF 1935**

Composition of registered holding company systems

Section 11 matters and other significant developments in active registered holding company systems

Exempt holding companies

Financing of active registered public utility holding companies and their subsidiaries

Competitive bidding

Protective provisions of first mortgage bonds and preferred stocks of public utility companies

Other matters

Request for declaratory order

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

Summary of activities

Jurisdictional, procedural and administrative matters

Trustee's investigation

Reports on plans of reorganization

Activities with regard to allowances

Intervention in Chapter XI proceedings

**PART VIII  
ADMINISTRATION OF THE TRUST INDENTURE ACT OF 1939**

**PART IX  
ADMINISTRATION OF THE INVESTMENT COMPANY ACT OF 1940**

Companies registered under the Act

Growth of investment company assets

Inspection and investigation program

Special staff study of investment companies

Current information

Applications and proceedings

**PART X**

**ADMINISTRATION OF THE INVESTMENT ADVISERS ACT OF 1940**

Inspection Program

Administrative proceedings

Registration statistics

**PART XI**

**OTHER ACTIVITIES OF THE COMMISSION**

Civil litigation

Criminal proceedings

Office of Program Planning

Complaints and investigations

Enforcement with respect to foreign securities

Canadian restricted list

Section of securities violations

Applications for nondisclosure of certain information

Activities of the Commission in accounting and auditing

International Bank for Reconstruction and Development

Inter-American Development Bank

Statistics and special studies

Issues registered under the Securities Act of 1933

New securities offerings

Individuals' saving

Private pension funds

Financial position of corporations

Plant and equipment expenditures

Directory of registered companies

Stock market data

Opinions of the Commission

Dissemination of information

Information available for public inspection

Publications

Organization

Personnel and financial management

## COMMISSIONERS AND STAFF OFFICERS

(As of January 1, 1965)

### **Commissioners**

WILLIAM L. CARY of New York, Chairman-Term Expires June 5, 1968

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

HUGH F. OWENS of Oklahoma-Term Expires June 5, 1965

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

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

Secretary: ORVAL L. DuBOIS

Executive Assistant to the Chairman: LEONARD M. LIEMAN

### **Staff Officers**

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

ROBERT BAGLEY, Associate Director.

SOLOMON FREEDMAN, Director, Division of Corporate Regulation.

J. ARNOLD PINES, Associate Director.

HAROLD V. LESE, Associate Director.

WALTER WERNER, Director, Office of Program Planning.

RALPH S. SAUL, Director, Division of Trading and Markets.

IRVING M. POLLACK, Associate Director.

PHILIP A. LOOMIS, Jr., General Counsel.

DAVID FERBER, Associate General Counsel.

WALTER P. NORTH, Associate General Counsel.

ANDREW BARR, Chief Accountant.

LEONARD HELFENSTEIN, Director, Office of Opinion Writing.

W. VICTOR RODIN, Associate Director.

WILLIAM E. BECKER, Management Analysis Officer.

FRANK J. DONATY, Comptroller.

ERNEST L. DESSECKER, Acting Records and Service Officer.

HARRY POLLACK, Director of Personnel.

## **REGIONAL AND BRANCH OFFICES**

### **Regional Administrators**

Region 1. New York, New Jersey.-Llewellyn P. Young; John J. Devaney, Associate Regional Administrator, 225 Broadway, New York, N.Y., 10007

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

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

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

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

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

Region 7. California, Nevada, Arizona, Hawaii.-Arthur E. Pennekamp, Federal Bldg., Box 36402, 450 Golden Gate Ave., San Francisco, Calif., 94103

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

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

### **Branch Offices**

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

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

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

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

Miami, Fla., 33230.-Room 1504, 51 SW., First Ave.

St. Louis, Mo., 63103.-Room 4266A Federal Building, 1520 Market Street.

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

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

### **COMMISSIONERS**

### **Manual F. Cohen, Chairman**

Chairman Cohen was born in Brooklyn, N.Y., on October 9, 1912. He holds a B.S. degree in social science from Brooklyn College of the City of New York. He received an LL.B. degree, cum laude, from Brooklyn Law School of St. Lawrence University in 1936, and was elected to the Philonomic Council. He is a member of the New York bar. In 1933-1934 he served as research associate in the Twentieth Century Fund studies of the securities markets. Chairman Cohen joined the Commission's staff as an attorney in 1942 after several years in private practice, serving first in the Investment Company Division and later in the Division of Corporation Finance, of which he was made Chief Counsel in 1953. He was named Adviser to the Commission in 1959 and in 1960 became Director of the Division of Corporation Finance. He was awarded a Rockefeller Public Service Award by the trustees of Princeton University in 1956 and for a period of 1 year studied the capital markets and the processes of capital formation and of government and other controls in the principal financial centers of Western Europe. In 1961, he was appointed a member of the Council of the Administrative Conference of the United States and received a Career Service Award of the National Civil Service League. From 1958 to 1962 he was lecturer in Securities Law and Regulation at the Law School of George Washington University and he is the author of a number of articles on securities regulation published in domestic and foreign professional journals. In 1962, he received an honorary LL.D. degree from Brooklyn Law School. He took office as a member of the Commission on October 11, 1961, for the term expiring June 5, 1963, and was reappointed for the term expiring June 5, 1968. He was designated Chairman of the Commission on August 21, 1964.

### **Byron D. Woodside**

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

National Security Resources Board and later with the Defense Production Administration as Assistant Deputy Administrator for Resources Expansion. He took office as a member of the Securities and Exchange Commission on July 15, 1960, for the term of office expiring June 5, 1962, and was reappointed effective June 5, 1962, for the term expiring June 5, 1967.

### **Hugh F. Owens**

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

### **Hamer H. Budge**

Commissioner Budge was born in Pocatello, Idaho, on November 21, 1910. He attended the College of Idaho, Caldwell, Idaho, and received an A.B. degree from Stanford University, Palo Alto, California, majoring in political science, and an LL.B. degree from the University of Idaho in Moscow, Idaho. He practiced law in the city of Boise, Idaho, from 1936 to 1950, except for 3 1/2 years in the United States Navy (1942-1945), with final discharge as Lieutenant Commander, United States Naval Reserve. He was elected to the Idaho State Legislature and served three sessions as representative from Ada County; assistant Republican floor leader two sessions; and majority floor leader one session. He was first elected to the 82nd Congress on November 7, 1950, and represented Idaho's Second Congressional District in the United States House of Representatives during the 82nd, 83rd, 84th, 85th, and 86th Congresses. In the House, he was a member of the Rules Committee, Appropriations Committee, and Interior Committee. During the period 1961 until his appointment to the Commission, he was District Judge in Boise. A member of the Idaho and American Bar Associations, he has been admitted to practice before the Supreme Court of Idaho and the Supreme Court of the United States. He took

office as a member of the Securities and Exchange Commission on July 8, 1964, for the term of office expiring June 5, 1969.

### **Francis M. Wheat**

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

## **PART I** **IMPORTANT RECENT DEVELOPMENTS**

### **Special Study of Securities Markets and its Implementation**

Fiscal year 1964, which marked the 30th year of the Commission's existence, and the months that followed was a period of extraordinary, even historic, significance for the Commission, the parts of the nation's economy which are concerned with the issuance and trading of securities, and, of course, public investors.

Shortly after the beginning of the year, the final two portions of the Report of the Special Study of Securities Markets were transmitted to Congress. The Special Study and the Report, constituting the most thorough examination of the securities markets since the early 1930's, have already had far-reaching consequences. Even while the study was still in progress, it stimulated an extensive self-examination by various segments of the securities industry, most notably the self-regulatory agencies, which resulted in a number of improvements in the rules and practices of those agencies. Secondly, the Report provided a foundation for the far-reaching legislative proposals submitted by the Commission to Congress in June 1963, which, with certain modifications, were enacted into law in August 1964. This legislation (the "Securities Acts Amendments of 1964") is summarized in Part II of this Report and referred to at appropriate points elsewhere in the Report.

The 1964 Amendments represent the most significant, statutory advance in Federal securities regulation and investor protection since 1940. In the main, they eliminate the differences in reporting requirements between issuers of securities listed on the exchanges and the larger issuers whose securities are traded over the counter, allow the self-regulatory agencies and the Commission to raise standards for entry into the securities business, and strengthen the Commission in dealing with broker-dealers and their employees. The legislation was strongly supported in principle by representatives of the securities industry and by others affected by it, and it benefited from extensive hearings by the Congress which permitted a thorough consideration of all of the issues involved. In signing the measure, the President stated: "The law signed today should further strengthen the securities markets and public confidence in them. Industry and government have worked together in the writing of these laws. Industry and government will work together in making these measures succeed."

A number of changes in the Commission's rules have already been effected or proposed to implement the new legislation or to conform the rules to it. One important area still to be implemented relates to the Commission's new authority to prescribe qualification standards and standards of conduct for those registered broker-dealers who are not members of a registered securities association. The Commission is now gathering more precise and fuller information as to the persons and firms affected and assessing the regulatory needs and problems which may be anticipated.

Significant progress has been made in the way of administrative action by the Commission and the self-regulatory agencies in implementing the recommendations of the Special Study Report. This is, of course, a continuing process, and what is referred to herein as prospective action may well be accomplished fact by the time this Report appears in print. In one of the principal areas also dealt with in the Amendments, qualification standards applicable to members and their employees have been tightened by the self-regulatory agencies. Proposed amendments to the Commission's net capital rule establishing for the first time a minimum net capital for broker-dealers were submitted to the industry on an informal basis for comments; comments have now been received and the proposal will be considered by the Commission before it is officially published for comment.

The Commission's staff has devoted considerable effort to assisting the self-regulatory groups in the formulation of effective rules governing selling practices. Primary emphasis was placed on supervision of salesmen by the principals of broker-dealer firms. The New York Stock Exchange (NYSE) adopted a new supervision rule in the spring of 1964. The Board of Governors of the National Association of Securities Dealers, Inc. (NASD) has approved a package of rules which set out in detail members' responsibilities for supervision, maintenance of certain records and handling of discretionary accounts. As of October 1964, these rules were submitted to the NASD membership for adoption. At the same time increased attention is being paid by the self-regulatory agencies to inspections

of brokerage firms and enforcement of selling practice rules. The NYSE, American, and several regional exchanges have adopted new rules and interpretations with respect to advertising and investment advice. The NASD Board of Governors has adopted a comprehensive interpretation with respect to these matters. And the Commission's staff has drafted comparable rules applicable to investment advisers which will be submitted informally to the industry for comment in the very near future.

Two of the areas which were studied in great depth by the Special Study and were subjects in its Report of recommendations for extensive changes were the activities and responsibilities of floor traders and specialists on the exchanges. These recommendations in turn gave rise to extended discussions between members of the staff and of the New York and American stock exchanges, culminating in the adoption, on June 2, 1964, of Rule 11a-1 under the Exchange Act, the first Commission rule ever adopted relating to floor trading, and the announcement, on September 24, 1964, of proposed Rule 11b-1 relating to specialists. Briefly, the purpose of Rule 11a-1 is to eliminate the abuses which the Commission found in floor trading on the two major exchanges. The new provisions require that traders must have substantial capital and they are subjected to high performance standards, various conditions designed to eliminate or minimize possible conflicts with public customers, and other restrictions intended to channel their trading for beneficial purposes. Upon the effectiveness of the rule, about 30 traders became registered on the NYSE, as compared with an estimated 300 persons who engaged in floor trading in recent years.

The proposed specialist rule, which also applies only to the two large New York exchanges, forms an integrated regulatory program together with rules which have been adopted by those exchanges and which will take effect concurrently with the effectiveness of Rule 11b-1. It contains three major parts. The first part would require the exchanges to have adequate rules in certain areas. Thus, for the first time the exchange rules would have to impose an affirmative obligation on specialists to utilize their capital as dealers to assist in the maintenance of a fair and orderly market, and the proposed exchange rules so provide. Additionally each exchange would have to establish adequate minimum capital amounts for specialists and provide effective methods of surveillance of specialist activities. Finally, the exchanges would be required to have rules on the brokerage responsibilities of specialists. Among the changes adopted by the exchanges are rules designed to assure that specialists' brokerage customers receive the best possible prices available and that the specialist does not give himself preferential treatment over his own customers. The second part of Rule 11b-1 would establish a procedure by which the Commission can review and disapprove new exchange rules relating to specialists if the Commission finds that they are inadequate to achieve the purposes described in the rule or are inconsistent with the public interest or the protection of investors. The Commission, of course, would retain the authority contained in Section 11 of the Exchange Act to adopt its own rules regulating the conduct of specialists if that becomes necessary. The third part of Rule 11b-1 would permit the Commission to commence

proceedings directly against a specialist in certain cases where an exchange has failed to do so or its action has been inadequate.

Turning to the over-the-counter markets, a new Rule 15c2-7 requires dealers entering quotations in a system such as the "sheets" of the National Quotation Bureau to disclose whether they are acting as correspondents, or have entered into some other financial arrangements with other dealers, and the identity of the latter. This information is to be revealed in the published quotations by symbol, number or otherwise. The rule should improve significantly the reliability of the wholesale quotations system and make it more informative. Extensive consideration is also being given by the Commission and the NASD to revisions of the retail quotations system.

During the 1964 fiscal year, the Commission established an Office of Regulation within its Division of Trading and Markets, one of whose primary responsibilities is to oversee the operations of the self-regulatory agencies. In pursuit of that goal, the Office has conducted continuing inspections of various operations of the exchanges and the NASD. Furthermore, the new Rule 17a-8, requiring the exchanges to file with the Commission reports of newly proposed rules, enables the Commission to be aware, on a continuing basis, of developments in an exchange's policies and to offer the exchange, at an early point, the benefit of its views. Important steps have also been taken by the self-regulatory agencies, particularly the NASD, to effect organizational changes in line with the views expressed in the Special Study Report.

The above are only some of the many steps already taken or under active consideration as a result of the Special Study and its Report.

### **Enforcement Activity: Proposed Revision of Annual Report Form for Investment Companies**

Although the Commission's attention during the 1964 fiscal year was focused to a considerable extent on the implementation of the Special Study's recommendations, its day-to-day enforcement activities, designed to combat fraudulent and other illegal practices in securities transactions, continued at a vigorous level. Details regarding the various aspects of these activities will be found in the appropriate parts of this Report. Among other things, 50 cases were referred to the Department of Justice for criminal prosecution during the year. On the civil side, 84 injunctive and related enforcement proceedings were instituted by the Commission in the Federal courts. And 458 investigations of securities transactions involving possible violations of the anti-fraud or other provisions of the securities acts were instituted. A substantial number of formal administrative proceedings were instituted with respect to broker-dealers and investment advisers-119 broker-dealer proceedings and 9 investment adviser proceedings.

The Commission's inspection program under the Investment Company Act of 1940, which has proceeded at a steadily accelerating pace since its inception in 1957, resulted

in a record total of 146 inspections during the 1964 fiscal year. Even at that rate, however, each of the 617 so-called "active" registered investment companies would be inspected only once every 4.2 years. To place the inspection program even on a 3-year cycle would require additional personnel and entail other related expenses. It also takes time and expense to train inspectors, many of whom must necessarily be new recruits, to achieve a high degree of proficiency. The Commission has proposed expansion of its inspection program because of its proven value.

Even under an expanded inspection program, certain investment companies inevitably require closer or prompter scrutiny. Because of this and the continued growth in the number and size of investment companies, the Commission considered that the public interest and the protection of investors would be served by strengthening the annual report filed by investment companies, and accordingly it published a proposal, shortly after the end of the fiscal year, to revise the present Form IST-30A-1, which is the current annual reporting form for all registered management investment companies except those which issue periodic payment plan certificates and small business investment companies licensed as such under the Small Business Investment Act of 1958.

The proposed form, which emerged from some 2 years of drafting and redrafting by the staff, with the benefit of discussions and correspondence with committees representing the investment company industry and the accounting profession, is designed to provide better disclosure to the investing public and to channel more effectively the Commission's inspection program. The form, either as published for comment or as it may be modified prior to adoption, should also serve to focus attention of the investment companies and their management more sharply on the prohibitions and requirements of the Investment Company Act and thus provide a significant measure of self-regulation.

### **Registration of New Security Offerings**

The 1964 fiscal year saw a slight increase over the previous year in the number of registration statements filed, but a substantial increase in the dollar amount involved. A total of 1,192 statements was filed during the year for securities with an aggregate offering price of \$18.6 billion, as compared to 1,159 statements and \$14.7 billion the preceding year.

In the course of the fiscal year, the Commission published an extensive guide containing numerous policies and practices of its Division of Corporation Finance with respect to the disclosures required by the Securities Act of 1933 and the rules thereunder in connection with the filing of registration statements under the Act.<sup>9</sup> It is expected that the publication of these policies and practices will not only be of assistance to registrants and their counsel and accountants in the preparation of registration statements, but also that it will relieve the staff of the Commission of the necessity for commenting on these matters in respect of such statements.

The Commission and its staff are constantly striving to reduce the time required to process registration statements, without, of course, diminishing the thoroughness of the examination procedure. During the year, there was a further significant reduction. Thus, with respect to registration statements which became effective during the year (excluding certain investment company filings), the median number of days elapsing from the date of filing to the date of the staff's letter of comment was 16, as compared with 27 the previous year; and the median time from filing to effective date was 36 days as compared to 52 days the year before. A total of 1,121 statements in the amount of \$16.9 billion became effective during the year. The chart below portrays the dollar volume and number of registrations with respect to securities which became registered during the fiscal years 1935 through 1964.

[chart omitted]

## **PART II** **LEGISLATIVE ACTIVITIES**

During the fiscal year 1964, Congressional hearings were completed on the Commission's proposals for amendment of the Federal securities laws. Hearings had previously been held in the United States Senate before a Subcommittee of the Committee on Banking and Currency, immediately prior to the close of the fiscal year 1963, and during those hearings the broad purposes of the legislation were strongly endorsed by all segments of the securities industry. S. 1642, the Senate bill embodying the Commission's proposals, was passed by the Senate on July 30, 1963 and referred to the House of Representatives. A Subcommittee of the Committee on Interstate and Foreign Commerce, House of Representatives, held hearings for a total of 13 days on S. 1642 and two companion bills, H.R. 6789 and H.R. 6793. [Footnote: These identical bills had been introduced on June 4, 1963. S. 1642 was introduced (by request) by Senator A. Willis Robertson, Chairman of the Senate Committee on Banking and Currency; H.R. 6789 was introduced by Representative Oren Harris, Chairman of the Committee on Interstate and Foreign Commerce, House of Representatives; H.R. 6793 was Introduced by Representative Harley O. Staggers, Chairman of the Subcommittee on Commerce and Finance of the Committee on Interstate and Foreign Commerce, House of Representatives.] After the close of the fiscal year, S. 1642 was passed by the House with certain amendments agreed to by the Senate, and was enacted as Public Law 88-467 on August 20, 1964. With some exceptions, the legislation as enacted was closely similar to the Commission's original proposals.

The Commission's legislative proposals were based upon the Report of the Special Study of Securities Markets and had two major purpose's. The first was to improve investor protections in the over-the-counter markets, primarily by extending to investors in a significant portion of the securities traded in those markets the fundamental protections

which had been afforded generally only to investors in securities listed on a national securities exchange. Under the legislation as proposed by the Commission, the registration, periodic reporting, proxy solicitation and insider reporting and trading provisions of the Securities Exchange Act of 1934 were to be extended to over-the-counter companies having more than 750 shareholders (500 shareholders at a subsequent date) and more than \$1,000,000 in assets. Companies meeting these standards would be required to file a registration statement containing material information regarding their businesses and to keep such information current by periodic reports; security holders whose proxies are solicited would be furnished with a proxy statement containing adequate and accurate information; and corporate "insiders" would be required to report their transactions in the securities of such companies and would be liable for short-swing trading profits in the securities of their company. Certain classes of companies were exempted from these requirements. The Commission's proposals in this area were embodied in Public Law 88-467, but were modified by the Congress to exempt also insurance companies which meet certain specified requirements.

The second purpose of the Commission's proposals was to strengthen the qualification standards for entrance into the securities business and to make more effective the disciplinary controls of the Commission and the rules of industry self-regulatory organizations over securities brokers and dealers and persons associated with them. Under the Commission's proposals registered securities associations were to be required to adopt rules, subject to Commission approval, establishing standards of training, experience and competence for members and their employees and to establish capital requirements for members. In addition, all over-the-counter broker-dealers would have been required to be members of a registered securities association in order to bring them within the self-regulatory scheme. Public Law 88-467 did not embody the latter proposal, but provides instead that if a broker-dealer is not a member of a registered securities association, the broker-dealer and all natural persons associated with the broker-dealer must meet such specified and appropriate standards with respect to training, experience and such other qualifications as the Commission finds necessary or desirable. Public Law 88-467 includes the Commission's other proposals in this area, including modification of the statutory scheme for disciplining violators so as to permit action directly against an individual; provision for the imposition of intermediate sanctions against a broker-dealer, such as temporary suspension or censure; and clarification of the authority of a national securities association to act directly against offending individuals.

In connection with Congressional consideration of the Commission's legislative proposals, members of the Commission testified before a Subcommittee of the House Committee on Interstate and Foreign Commerce on November 19 and 20, 1963 and on February 18 and 19, 1964. In addition Chairman Gary testified on March 5, 1964 before the House Committee on the District of Columbia in favor of H.R. 9419, a bill to provide for the regulation of the sale of securities in the District of Columbia and the licensing of persons engaged in that activity. [Footnote: The bill was enacted into law on August 30, 1964, as Public Law 88-503.] On June 23, 1964 Chairman Gary also testified before the

Subcommittee on Census and Government Statistics of the House Committee on Post Office and Civil Service in connection with the Subcommittee's inquiry into the reporting and paper work requirements of the various Governmental agencies. During the fiscal year the Commission analyzed a total of 37 bills and legislative proposals submitted by Congressional Committees or the Bureau of the Budget.

### **PART III** **REVISION OF RULES, REGULATIONS AND FORMS**

Several new rules were either adopted or proposed during the 1964 fiscal year as a direct result of recommendations made in the Report of the Special Study of Securities Markets. In addition, the Commission maintains a continuing program of reviewing its rules, regulations and forms in order to determine whether any changes are appropriate. Certain members of the staff are specifically assigned to this task, but changes are also suggested, from time to time, by other members of the staff and by persons outside of the Commission who are subject to the Commission's requirements or who have occasion to work with those requirements in a professional capacity, such as underwriters, attorneys and accountants. With a few exceptions provided for by the Administrative Procedure Act, proposed new rules, regulations and forms and proposed changes in existing rules, regulations and forms are published in preliminary form for the purpose of obtaining the views and comments of interested persons, including issuers and various industry groups, which are given careful consideration. The changes which were made during the fiscal year as well as those proposed changes which were published in preliminary form and were pending at the end of the year are described below.

[Footnote: The rules and regulations of the Commission are published in the Code of Federal Regulations, the rules adopted under the various acts administered by the Commission appearing in the following parts of Title 17 of that Code :

Securities Act of 1933, pt. 230.

Securities Exchange Act of 1934, pt. 240.

Public Utility Holding Company Act of 1935, pt. 250.

Trust Indenture Act of 1939, pt. 260.

Investment Company Act of 1940, pt. 270.

Investment Advisers Act of 1940, pt. 275.]

### **THE SECURITIES ACT OF 1933**

#### **Adoption of Rule 156**

During the fiscal year, the Commission adopted Rule 156 which defines as "transactions by an issuer not involving a public offering" in Section 4 (1) of the Securities Act of

1933, transactions which are exempted from the Investment Company Act of 1940 by Rule 3c-3, recently adopted thereunder.

Rule 3c-3 exempts from the provisions of the Investment Company Act transactions by any insurance company with respect to certain group annuity contracts with employers or their representatives covering at least 25 employees and providing for the administration of funds held by such companies in one or more so-called "separate accounts" established and maintained pursuant to state law. It has been represented to the Commission that because of the variety and complexity of such contracts, they must be separately negotiated with employers who retain expert advisers, are fully informed in the matter and are in a position to fend for themselves.

The new rule under the Securities Act provides that transactions of the character referred to therein shall come within the rule only if the transaction is not advertised by any written communication which, insofar as it relates to a separate account group annuity contract, does more than identify the insurance company, state that it is engaged in the business of writing such contracts and invite inquiries in regard thereto. The rule provides, however, that the limitation on advertising shall not apply to disclosure made in the course of direct discussion or negotiation of such contracts.

It should be noted that the rule provides an exemption only from the provisions of Section 5 of the Act and does not afford any exemption from the anti-fraud provisions of the Act.

### **Amendments to Form S-1, Form S-8 and Form S-11**

The Commission announced during the fiscal year that it had under consideration amendments to Forms S-1, S-8, and S-11 believed to be necessary and appropriate in view of changes made by the Revenue Act of 1964 in the provisions of the Internal Revenue Code relating to stock options eligible for special tax treatment. (See Section 221 of the Revenue Act of 1964, Public Law 88-272, 78 Stat. 19). These changes limit the types of stock options which are to receive favorable tax treatment; they eliminate the term "restricted stock options," except with respect to options which have already been granted or may be granted pursuant to existing plans or contracts; and they designate other tax-favored options as "qualified" or as options granted pursuant to "employee stock purchase plans."

The three forms, which are used for the registration of securities under the Securities Act, require the furnishing of certain information regarding options to purchase securities. The proposed amendments were designed to make these forms consistent with the Internal Revenue Code as amended, i.e., to provide for all tax-favored options the same exemptive or other favorable treatment as had been extended to the previous tax-favored options.

Subsequent to the close of the fiscal year, the proposed amendments were adopted.

## **THE SECURITIES EXCHANGE ACT OF 1934**

### **Amendments of Rules 10b-6 and 16b-3 and Form 10**

In view of the changes made by the Revenue Act of 1964 in the provisions of the Internal Revenue Code relating to stock options eligible for special tax treatment, as previously described, the Commission announced during the fiscal year that it had under consideration the adoption of amendments to Rules 10b-6 and 16b-3 and Form 10 under the Securities Exchange Act of 1934, which would conform those rules and the form to the changes in the Code.

Form 10 is used for the registration of securities on a national securities exchange. Rule 10b-6 makes it unlawful for certain persons participating or expecting to participate in a distribution of securities, including the issuer of the securities involved in such distribution, to purchase any such security, or any security of the same class or series, until completion of their participation in the distribution, subject to specified exceptions. Paragraph (e) of the rule exempts from its provisions certain distributions pursuant to stock option plans. Rule 16b-3 provides an exemption from the insider trading provisions of Section 16 (b) for the acquisition of stock options pursuant to a plan meeting specified conditions.

The proposed amendments were adopted subsequent to the close of the fiscal year.

### **Adoption of Rule 11a-1**

During the fiscal year, the Commission adopted a new Rule 11a-18 under Section 11 of the Exchange Act to limit or restrict floor trading on national securities exchanges. The rule provides that no member of a national securities exchange may, while on the floor of such exchange or other premises made available for the use of members generally, initiate any transaction in any security traded on the exchange for any account in which he has an interest or in which he is vested with more than the usual broker's discretion, unless the transaction comes under specified exemptions or conditions. An important exemption relates to transactions effected in conformity with a plan adopted by an exchange designed to eliminate floor trading activities not beneficial to the market, provided such plan is approved by the Commission.

The propriety of floor trading by members has been a highly controversial subject over the years and was one which particularly concerned Congress in 1934 in its consideration of the Exchange Act. Although early drafts of the legislation contemplated a complete prohibition of the practice, the statute as finally enacted included in Section 11 (a) a broad grant of authority to the Commission to prescribe such rules and regulations as it

might deem necessary to either regulate or prevent floor trading by members. The Commission in the past preferred not to adopt its own rules but relied instead upon rules adopted by the exchanges to control floor trading. Experience demonstrated, however, and studies by the Commission confirmed, that regulation by the exchanges was not effective and in many respects misdirected. Floor traders retained their significant and unwarranted private trading advantage in the market without contributing any corresponding benefit to public investors, continued to concentrate their activities in the more active stocks where member trading is least needed, continued to accentuate price movements and frequently interfered with the orderly execution of public brokerage orders by delaying their consummation or by adversely affecting the price at which they are executed. Rule 11a-1 and the exchange plans adopted pursuant to it are intended to provide a comprehensive system for the regulation of floor trading.

Both the New York Stock Exchange and the American Stock Exchange have adopted floor trading plans which have been approved by the Commission and declared effective. The regional exchanges have been granted exemptions from the provisions of the rule.

The NYSE and AMEX plans are essentially identical and provide for an exemption from the floor trading prohibition for a new member category known as the "registered trader." These members will be required to meet capital requirements over and above the capital required for other member activities and will be required to pass an examination on the rules and requirements applicable to registered traders. They will be prohibited from executing brokerage orders and floor trading in the same security during a single trading session, will be compelled by a series of new rules to conduct their business in a way calculated to contribute to the orderliness of the market and will be prohibited from engaging in transactions which would have a disruptive effect upon the market. Finally, they will be required to yield priority, precedence or parity to public orders. The Commission anticipates that the net effect of Rule 11a-1 and these exchange plans will be to restrict floor trading to a small group of professional dealers whose activities will be of maximum assistance to the public in the execution of orders on the exchange.

### **Amendment of Rule 14a-3**

Rule 14a-3 relates to the information to be furnished to security holders in connection with the solicitation of proxies. It provides, among other things, that where the management of an issuer solicits proxies for an annual meeting of security holders for the purpose of electing directors, its proxy statement shall be accompanied or preceded by an annual report to such security holders containing such financial statements for the last fiscal year as will in the opinion of management adequately reflect the financial position and operations of the issuer. During the fiscal year, the Commission adopted certain amendments to the rule.

The amended rule requires the inclusion of consolidated financial statements of the issuer and its subsidiaries in such annual reports to security holders if such statements are

necessary to reflect adequately the financial position and results of operations of the issuer and its subsidiaries. However, in such cases the individual financial statements of the issuer may be omitted.

Compliance with the requirements for financial statements filed with the Commission is not required, but any material differences between the principles of consolidation or other accounting principles and practices, or methods of applying accounting principles or practices, applicable to such statements and those reflected in the report to security holders must be noted and the effect thereof reconciled or explained in such report. Provision is made, however, for the omission of details and for suitable condensation in the financial statements included in the report to security holders, provided this does not under the circumstances result in the presentation of misleading financial statements.

The amended rule provides that the financial statements included in reports to security holders shall be certified by independent public or certified public accountants, unless certification is not required in annual reports filed with the Commission or the Commission finds that certification would be impracticable or would involve undue effort or expense. The amended rule also includes certain other minor changes.

#### **Amendment to Rules 13a-15 and 15d-15 and Form 7-K**

Rules 13a-15 and 15d-15 require certain real estate companies to file quarterly reports with respect to distributions to shareholders. Form T-K is the form prescribed for such reports. During the fiscal year, the Commission adopted certain amendments to Rules 13a-15 and 15d-15 and Form T-K.

The rules as amended require the filing of quarterly reports on Form T-K by real estate investment trusts and by real estate companies which as a matter of policy or practice make distributions to shareholders from sources other than current or retained earnings. Other real estate companies are required to file reports with respect to quarters in which a distribution is made from a source other than current or retained earnings. The amended rules provide for the filing of reports not more than 60 days after the end of the fiscal quarter to which they relate except that the report for the last quarter of the fiscal year must be filed not more than 120 days after the close of the fiscal year. Prior to the amendment the quarterly reports were required to be filed within 45 days after the close of the quarter. The extension of the period for filing reports for the first three quarters should provide adequate opportunity for the collection of information called for by the report by issuers holding numerous properties. The extension of the period for filing the report for the fourth quarter should provide opportunity for reflecting in the information reported any year-end adjustments made in connection with the annual audit of the issuer's accounts or otherwise.

Form T-K has been amended to eliminate the two-column reporting previously required and to clarify the language of the items. In particular, the form has been amplified to

provide directions for treatment of minority interests, mortgages received on the sale of property and businesses acquired during the period covered by the report.

### **Adoption of Rule 15c2-7**

The rule implements a recommendation of the Report of the Special Study of Securities Markets designed to improve the reliability and informativeness of the wholesale quotations system through which dealers advertise their buying or selling interests in securities traded over-the-counter. The "sheets" published by the National Quotation Bureau, Inc., are the primary medium for the dissemination of wholesale or "inside" quotations among broker-dealers in the over-the-counter markets. Broker-dealers use the sheets to communicate buying and selling interests in securities by placing their names in the sheets, together with accompanying quotations. However, if a broker-dealer submits a quotation to the sheets on behalf of another broker-dealer, there is no indication in the sheets that the appearing broker-dealer is quoting a market on behalf of another. The Special Study pointed out that the failure to differentiate in any way quotations entered for correspondents and quotations representing multiple expressions of the same market, prevents persons using the sheets from determining the actual depth and activity of the market for a particular security and the identity of the actual primary market makers for such security. This failure to differentiate quotations entered by one broker-dealer on behalf of another from other quotations may also result, as documented by the Special Study, in the use of the sheets for fraudulent or manipulative purposes.

The purpose of Rule 15c2-7 is to insure that an inter-dealer quotation system clearly reveals those instances where two or more quotations in different names for a particular security represent a single quotation or where one broker-dealer appears as a correspondent of another. The rule requires a broker-dealer who is a correspondent for another firm for a particular security and enters quotations in the sheets to inform the service of the correspondent arrangement and the identity of his correspondent. By requiring disclosure of the correspondent, as well as of the fact of such an arrangement, the rule permits users of the sheets to determine the identity of dealers making an inter-dealer market for a security -- a fact which may be extremely pertinent in evaluating its marketability.

The rule also requires that where two or more broker-dealers place quotations in the sheets pursuant to any other arrangement between or among broker-dealers, the identity of each broker-dealer participating in any such arrangement or arrangements, and the fact that an arrangement exists, must be disclosed. Because of the variety of market-making arrangements between broker-dealers resulting in appearances in the sheets, the rule does not limit the type of arrangement covered; the purpose of the rule is to cover any arrangement between broker-dealers, such as joint accounts, guarantees of profit or against loss, commissions, mark-ups, mark-downs, indications of interest and accommodations.

### **Adoption of Rule 15c3-2**

The Special Study of Securities Markets found that many customers of broker-dealers were unaware (1) that when they leave free credit balances (funds which the customer has an unrestricted right to withdraw) with a broker-dealer the funds generally are not segregated and held for the customer but are commingled with other funds of the broker-dealer and used in the operation of his business, and (2) that the relationship between the broker-dealer and the customer as a result thereof is that of debtor-creditor. The purpose of Rule 15c3-2 is to put customers on notice that free credit balances left with the broker-dealer may be used in the business and therefore may be at risk. The rule, effective August 3, 1964, prohibits a broker or dealer from using in his business any funds arising out of any free credit balance carried for the account of any customer unless he has established adequate procedures pursuant to which each such customer will be given or sent, together with or as a part of the customer's statement of account, whenever sent, but not less frequently than once every 3 months, a written statement informing the customer of the amount due, and containing a written notice that such funds are not segregated and may be used in the operation of the business of the broker-dealer, and that such funds are payable on demand. The rule provides an exemption for a banking institution supervised and examined by state or Federal authority having supervision over banks.

### **Adoption of Rule 16b-9**

During the fiscal year, the Commission adopted a new Rule 16b-9 which exempts from the operation of Section 16 (b) of the Securities Exchange Act of 1934 certain transactions in which shares of stock are exchanged for similar shares of stock of the same issuer.<sup>14</sup> Section 16 (b) provides for the recovery, by or on behalf of an issuer of equity securities registered under the Exchange Act, of short-term trading profits realized by directors, officers and principal security holders of the issuer. The Commission is authorized to exempt from Section 16 (b) transactions not comprehended within the purpose of that section.

The new rule exempts from the operation of Section 16 (b) any acquisition or disposition of shares of stock of an issuer in exchange for an equivalent number of shares of another class of stock of the same issuer pursuant to a right of conversion under the terms of the issuer's charter or other governing instruments. The exemption is available only if (1) the shares surrendered and those acquired in exchange therefor evidence substantially the same rights and privileges except that the shares surrendered may, in the discretion of the board of directors, receive a lesser dividend than the shares for which they are exchanged and (2) the transaction was effected in contemplation of a public sale of the shares acquired in the exchange. This rule is intended to relate only to the typical Class A and B common equity securities.

### **Adoption of Rule 17a-8**

During the fiscal year, the Commission adopted Rule 17a-8, which requires national securities exchanges to file reports of proposed rule changes with the Commission prior to any final exchange adoption of such changes. Under the Exchange Act the Commission has the responsibility for overseeing the self-regulatory functions of national securities exchanges. Under Sections 11, 19 (b) and other sections of the Act, the Commission has broad powers and responsibilities with respect to the rules of such exchanges, including the power to alter or supplement exchange rules in specified areas of exchange operations and the power to enact its own rules in other areas if the exchanges' rules are inadequate to protect investors and assure fair dealing. Chapter XII of the Special Study Report concluded that the Commission's existing procedures for the review of exchange rules did not appear to be sufficient to assure the needed continuous oversight on the part of the Commission to enable it to discharge its responsibilities under the Act. The Report recommended that the exchanges be required to file all proposed rule changes with the Commission in advance of effectiveness, as has always been required in the case of rules of the National Association of Securities Dealers, Inc. Rule 17a-8 was adopted in response to that recommendation and is intended to afford the Commission an adequate interval for orderly review of new exchange rules or amendments before they become effective.

The rule provides that each national securities exchange shall file a report of any proposed change in, or addition to, its rules not less than 3 weeks before it is submitted for any action by the membership or any governing body of the exchange. If any substantive change is made in the proposal after the report is filed with the Commission, a new 3-week notice is required unless the change is made to conform it to a suggestion made by the Commission. The rule also provides that if emergencies arise in which a report cannot be filed as provided above, the exchange shall give the Commission as much advance notice as the circumstances permit, together with a written statement of the reasons why the filing of a report as required was impracticable.

### **Proposed Rule 17a-9**

During the fiscal year, the Commission staff drafted a proposed rule and related reporting forms requiring broker-dealers to report certain information concerning over-the-counter trading in common stocks traded on national securities exchanges. The proposed rule, to be designated Rule 17a-9, was published for public comment shortly after the end of the fiscal year. It is intended to implement recommendations of the Special Study of Securities Markets.

The Report of the Special Study describes a striking increase in the volume of off-board trading in common stocks traded on the New York Stock Exchange and other national securities exchanges in recent years. But the Study found "an acute lack of data" concerning this trading, which it described as the "third market." The Study recommended correction of this deficiency by establishment of a system for the

identification of market makers and for reporting information concerning trading in this market.

The proposed rule and reporting forms are designed to enable the Commission to obtain information on the third market on a continuous basis and thus keep abreast of any regulatory problems which may develop therein. It would obtain two basic types of information: (1) an identification of broker-dealers making off-board markets in common stocks traded on any national securities exchange; and (2) summaries of over-the-counter trading in common stocks traded on the New York Stock Exchange.

### **Proposed Amendments to Form 8-K**

Form 8-K is prescribed for current reports filed pursuant to Sections 13 and 15 (d) of the Securities Exchange Act. During the 1962 fiscal year, the Commission announced that it had under consideration certain proposed amendments to Form 8-K and invited public comments. The amendments are designed to bring to the attention of investors prompt information regarding matters such as the pledging of securities of the issuer or its affiliates under circumstances that a default will result in a change in control of the issuer, changes in the board of directors otherwise than by stockholder action, the acquisition or disposition of a significant amount of assets otherwise than in the ordinary course of business, interests of management and others in certain transactions, and the issuance of debt securities by subsidiaries. These amendments were still under consideration at the close of the last fiscal year.

## **THE INVESTMENT COMPANY ACT OF 1940**

### **Amendment of Rule 3c-3**

During the fiscal year, the Commission invited public comments on a proposed amendment of Rule 3c-3 under the Investment Company Act, and, shortly after the close of the fiscal year, the rule was amended.

Prior to its amendment, Rule 3c-3 exempted from the Act transactions of insurance companies With respect to group annuity contracts entered into in connection with a plan of retirement which meets the requirements of Sections 401 or 404 (a) (2) of the Internal Revenue Code and which provides for the allocation of part or all of the employer's contributions to a separate account established and maintained pursuant to legislation under which income, gains and losses, whether or not realized, from assets allocated to the account were credited to or charged against that account without regard to other income, gains or losses of the insurance company. In order to qualify for the exemption the group annuity contract was required to provide that the retirement benefits for covered employees would be payable in fixed dollar amounts, i.e., the contract could not

permit the retirement benefits payable to employees to reflect or be measured by the investment results of the assets allocated to the separate account.

The rule as amended permits group variable contracts to provide for employees' retirement benefits to be payable in varying amounts but the benefits may vary to the extent, and only to the extent, of the employer's contributions to the separate account. No variable benefits are permitted in respect of the contributions of the employees. In all other respects, the restrictions and conditions of the rule remain intact.

### **Adoption of Rule 12d-1**

During the fiscal year the Commission invited public comments on a proposed Rule 12d-1 under the Investment Company Act, and after the close of the fiscal year, the rule was adopted. Rule 12d-1 provides conditional exemptions from the provisions of Section 12 (d) (3) of the Act which prohibits a registered investment company from purchasing or acquiring any security issued by, or any other interest in the business of, a person who is a broker, a dealer, is engaged in the business of underwriting, or is an investment adviser of an investment company or an investment adviser registered under the Investment Advisers Act of 1940.

The purpose of the rule is to permit registered investment companies, under specified circumstances, to retain in, or acquire for, their portfolios securities of companies which are directly or indirectly engaged in the businesses referred to in Section 12 (d) (3), provided that the portfolio companies are primarily and predominantly engaged in other businesses and derive or will derive a relatively insignificant portion of their gross revenues from such businesses.

The exemption is available for securities holdings or acquisitions of securities by registered investment companies if the portfolio company, during each of its most recent 3 fiscal years, derived not more than 15 percent of its total gross revenues from the specified businesses, and if the registered investment company and all companies under the same or affiliated management as the registered company immediately after the acquisition do not, in the aggregate, own more than 10 percent of the total outstanding voting stock of the portfolio company. An exemption is also available for the purchase by a registered investment company of an unlimited percentage of the securities of a portfolio company if the portfolio company, during each of its most recent 3 fiscal years, has not derived more than 1 percent of its total gross revenues from the businesses referred to in Section 12 (d) (3) of the Act.

A registered investment company which claims an exemption must examine its portfolio semi-annually to determine whether its holdings are in compliance with the conditions prescribed in the rule, and, if any holding is not, the company is required to dispose of it within 90 days.

The rule further exempts all investments by registered investment companies, without regard to the percentage of voting securities held, in certain types of businesses, such as small loan, factoring and finance companies which technically might be regarded as being engaged in a securities business.

### **Amendment of Rule 17a-6**

During the fiscal year, the Commission amended Rule 17a-6 under the Investment Company Act to provide certain additional exemptions from the prohibitions of Section 17 (a) of the Act.

Prior to its amendment, Rule 17a-6 exempted from the prohibitions of paragraphs (1) and (3) of Section 17 (a) of the Act the sale of securities or other property to, and the borrowing of money or other property from, a registered investment company which is a small business investment company licensed under the Small Business Investment Act of 1958 (SBIC) where such transactions were prohibited solely because the SBIC owns, controls, or holds with power to vote, voting securities of a small business concern to an extent that creates an affiliation within the meaning of the Act.

The purpose of both the previous rule and of the rule as amended is to eliminate the need to file and process applications for exemption from Section 17 (a) in circumstances in which it appears that there is no likelihood of overreaching of the investment company and that the transaction would not be unreasonable or unfair to such company. The rule as amended is broader in that it extends the exemption so as to include not only transactions to which a registered investment company, which is an SBIC, is a party, but also transactions to which another type of registered investment company (generally referred to as a "venture capital investment company"), or a company controlled by such a registered investment company, is a party. The rule now specifies certain classes of persons who have an affiliation with the registered investment company of a character which creates the possibility of overreaching of the investment company in a transaction involving the registered investment company and such persons. An exemption under the rule is not available, if such a person is a party to the transaction, or has or within 6 months prior to the transaction had, or pursuant to an arrangement will acquire, a direct or indirect financial interest in a party (except the registered investment company) to the transaction.

The amended rule also exempts transactions involving a registered investment company other than an SBIC or venture capital investment company and a company controlled by or affiliated with the registered investment company, if under the standards set forth in the preceding paragraph it appears that there is no likelihood of overreaching of the investment company, and if all the outstanding securities of the controlled or affiliated company are beneficially owned by not more than 100 persons.

The rule as amended deletes the requirement of the original Rule 17a-6 that the pertinent details of each transaction for which exemption is claimed under the rule shall be reported by the investment company in its next annual report to stockholders and in a report filed with the Commission within 30 days after the end of each semi-annual accounting period of the investment company.

#### Amendment of Rule 17g-1

During the fiscal year the Commission invited public comments on a proposed amendment of Rule 17g-1, and after the close of the fiscal year, an amended rule was adopted. Rule 17g-1 requires that each registered management investment company provide and maintain a fidelity bond against larceny and embezzlement covering each officer and employee of the investment company who may have access to securities or funds of the company.

The rule as amended adds to the provisions of the prior rule requirements that the amount of the fidelity bond be determined at least once each year, and that the registered company shall file with the Commission a copy of each amendment to the bond, shall inform each of its directors of any proposed cancellation, termination or modification of the bond, and shall furnish to such directors and to the Commission information as to the making and settlement of claims under the bond.

In addition, the amended rule requires that each bond must provide, in substance, that if the insurance company proposes to cancel, terminate or modify the fidelity bond, it shall so notify the registered company and the Commission not less than 30 days prior to the effective date of such action.

The rule also places the obligation for filing information with respect to the making and settlement of claims under fidelity bonds on the registered company, rather than requiring, as originally proposed, that the bond contain provisions pursuant to which the insurance company would furnish the information to the Commission. The adopted rule also provides that this information shall be nonpublic unless the Commission determines to the contrary.

#### **Proposed Amendment of Rule 20a-2**

During the fiscal year the Commission invited public comments on a proposed amendment of Rule 20a-2. The rule presently requires that a proxy statement relating to a registered investment company include certain information with respect to, among other things, the investment advisory contract, ownership and control of the investment adviser, and interests of the management of the investment company in the investment adviser. Except where the investment adviser is a bank, a balance sheet of the investment adviser must be included, unless the Commission, for good cause, permits the omission of such balance sheet. Certain information also is required with respect to the relationship

between the investment company or the investment adviser and the principal underwriter of the investment company's securities. Where action is to be taken by the security holders of the investment company with respect to an investment advisory contract, information is also to be included with respect to such contract and with respect to certain collateral arrangements or understandings in connection therewith.

The effect of the proposed revision of Rule 20a-2 would be to require: (1) disclosure of information with respect to the principal underwriter, the prospective principal underwriter and the principal underwriting contract comparable to that now required with respect to the investment adviser, the prospective investment adviser and the investment advisory contract; (2) disclosure of certain financial information concerning (a) the investment company, (3) the investment advisory contract where action is to be taken by security holders with respect thereto, and (4) the principal underwriting contract where action is to be taken by security holders with respect thereto; and (5) the inclusion of such financial information with respect to both the investment advisory contract and the principal underwriting contract if action is to be taken by security holders with respect to either and the investment adviser and principal underwriter are the same person or one is an affiliated person of, or an affiliated person of an affiliated person of, the other.

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

#### **PART IV ADMINISTRATION OF THE SECURITIES ACT OF 1933**

The Securities Act of 1933 is primarily a disclosure statute designed to provide investors with material facts concerning securities publicly offered for sale by an issuing company or any person in a control relationship to such company by the use of the mails or instrumentalities of interstate commerce, and to prevent misrepresentation, deceit, or other fraudulent practices in the sale of securities generally. Disclosure is obtained by requiring the issuer of such securities to file with the Commission a registration statement which includes a prospectus containing significant financial and other information about the issuer and the offering. The registration statement is available for public inspection as soon as it is filed. Although the securities may be offered for sale after the registration statement has been filed, sales may not be made until the registration statement has become "effective." A copy of the prospectus must be furnished to each purchaser at or before the sale or delivery of the security in order that he may have the opportunity to evaluate the securities and make an informed investment decision. The registrant and the underwriter are basically responsible for the contents of the registration statement. The Commission has no authority to control the nature or quality of a security to be offered for public sale or to pass upon its merits or the terms of its distribution. Its action in permitting a registration statement to become effective does not constitute approval of the

securities, and any representation to the contrary to a prospective purchaser of securities is made unlawful by Section 23 of the Act.

## **DESCRIPTION OF THE REGISTRATION PROCESS**

### **Registration Statement and Prospectus**

Registration of any security proposed to be publicly offered may be effected by filing with the Commission a registration statement on the applicable form containing the prescribed disclosure. Generally speaking, when a registration statement relates to a security issued by a corporation or other private issuer, it must contain the information, and be accompanied by the documents, specified in Schedule A of the Act; when it relates to a security issued by a foreign government, the material specified in Schedule B must be supplied. Both schedules specify in considerable detail the disclosure which should be made available to an investor in order that he may make a realistic appraisal of the company and the securities and thus exercise an informed judgment whether to buy the security. In addition, the Act provides flexibility in its administration by empowering the Commission to classify issues, issuers and prospectuses, to prescribe appropriate forms, and to increase, or in certain instances vary or diminish, the particular items of information required to be disclosed in the registration statement as the Commission deems appropriate in the public interest or for the protection of investors. The Commission has prepared special registration forms which vary in their disclosure requirements so as to provide maximum disclosure of the essential facts pertinent in a given type of offering while at the same time minimizing the burden and expense of compliance with the law.

In general, the registration statement of an issuer other than a foreign government must describe such matters as the names of persons who participate in the direction, management, or control of the issuer's business; their security holdings and remuneration and the options or bonus and profit-sharing privileges allotted to them; the character and size of the business enterprise, its capital structure, past history and earnings, and its financial statements, certified by independent accountants; underwriters' commissions; payments to promoters made within 2 years or intended to be made; the interest of directors, officers and principal stockholders in material transactions; pending or threatened legal proceedings; and the purposes to which the proceeds of the offering are to be applied. The prospectus constitutes a part, of the registration statement and presents the more important of the required disclosures.

### **Examination Procedure**

Registration statements are examined by the staff of the Division of Corporation Finance for compliance with the standards of accurate and full disclosure. The registrant is usually notified by an informal letter of comment of any material respects in which the statement

appears to fail to conform with the applicable requirements and is afforded an opportunity to file correcting or clarifying amendments. In addition^ the Commission has power, after notice and opportunity for hearing, to issue an order suspending the effectiveness of a registration statement if it finds that material representations are misleading, inaccurate or incomplete. In certain cases, such as where the deficiencies in a registration statement appear to stem from careless disregard of applicable requirements or from a deliberate attempt to conceal or mislead, a letter of comment is generally not sent and the Commission either institutes an investigation to determine whether "stop-order" proceedings should be instituted or immediately institutes such proceedings. Information about the use of the "stop-order" power during 1964 appears below under "Stop-Order Proceedings."

### **Time Required to Complete Registration**

The Commission's staff endeavors to complete its examination of registration statements in as short a time as possible. The Act provides that a registration statement shall become effective on the 20th day after it is filed (or on the 20th day after the filing of any amendment thereto). Since most registration statements require one or more amendments, they usually do not become effective until some time after the original 20-day period. The period between filing and effective date is intended to afford investors an opportunity to become familiar with the proposed offering through the dissemination of the preliminary form of prospectus. The Commission is empowered to accelerate the effective date so as to shorten the 20-day waiting period where the facts justify such action. In exercising this power, the Commission is required to take into account the adequacy of the information respecting the issuer theretofore available to the public, the ease with which the facts about the new offering can be disseminated and understood, and the public interest and the protection of investors. The note to Rule 460 under the Act indicates, for the information of interested persons, some of the more common situations in which the Commission considers that the statute generally requires it to deny acceleration of the effective date of a registration statement.

The median number of calendar days which elapsed from the date of original filing to the effective date with respect to the 960 registration statements that became effective during the 1964 fiscal year was 36, compared with 52 days for 985 registration statements in fiscal year 1963 and 78 days for 1,646 registration statements in fiscal year 1962. The number of registration statements filed during fiscal year 1964 was 1,192, as compared with 1,159 and 2,307 in fiscal years 1963 and 1962, respectively.

The following table shows by months during the 1964 fiscal year the number of calendar days elapsed during each of the three principal stages of the registration process for the median registration statement, the total elapsed time and the number of registration statements effective.

[table omitted]

## VOLUME OF SECURITIES REGISTERED

During the fiscal year 1964, a total of 1,121 registrations of securities in the amount of \$16.9 billion became effective under the Securities Act of 1933. These figures represent a decrease of 3 percent in the number of statements, but an increase of 14 percent in dollar amount of registrations over the preceding fiscal year. The chart on page 7 shows the number and dollar amounts of registrations from 1935 to 1964.

These figures cover all registrations which became effective, including secondary distributions and securities registered for other than cash sale, such as issues exchanged for other securities, and securities reserved for conversion. Of the dollar amount of securities registered in 1964, nearly 88 percent was for account of issuer for cash sale, over 3 percent for account of issuer for other than cash sale, and 9 percent for account of others, as shown below.

[table omitted]

The \$14.8 billion of securities offered for cash sale for account of issuer represented an increase of \$2.9 billion, or 25 percent, over the previous year. Registration of new common stock issues aggregated \$10 billion, \$2.8 billion more than in the 1963 fiscal period. The increase in common stock registered largely reflected a \$1.2 billion issue offered to stockholders by American Telephone & Telegraph Co., (a record-size issue) and a \$200 million issue of the Communications Satellite Corporation, as well as increased registrations of investment company issues and stock options. Registrations of new bonds, notes and debentures were only slightly higher than in the preceding year, and accounted for \$4.6 billion of the 1964 volume. Preferred stock issues registered for account of the issuer amounted to \$224 million, somewhat lower than in 1963. Appendix Table 1 shows the number of statements which became effective and total amounts registered for each of the fiscal years 1935 through 1964, and contains a classification, by type of security, of issues to be offered for cash sale on behalf of the issuer during those years.

Corporate issues to be offered immediately after effective registration amounted to \$6.5 billion, an increase of \$1.4 billion over the previous year. Of the total, communication companies accounted for \$2.2 billion of issues, including the two issues mentioned above. A larger amount was also registered by companies in the financial and real estate group, the total being \$1 billion, almost double the amount of the preceding year. Among the other major industry groups, electric, gas and water companies registered \$2.1 billion of securities, slightly under the 1963 total, and manufacturing companies registered over \$900 million of issues, a moderately higher amount than in the preceding year. Registration of foreign government issues scheduled for immediate sale decreased to \$120 million from \$265 million in the preceding year, but in addition, one foreign

government issue in the amount of \$400 million, planned for offering on a continuous basis over a number of years, was effectively registered.

[table omitted]

Of the \$6.5 billion expected from the immediate cash sale of corporate securities for the account of issuer in 1964, 86 percent was designated for new money purposes, including plant, equipment and working capital, 5 percent for retirement of securities, and 9 percent for all other purposes including purchases of securities.

## **REGISTRATION STATEMENTS FILED**

During the 1964 fiscal year, 1,192 registration statements were filed for offerings of securities aggregating \$18.6 billion, as compared with 1,159 registration statements filed during the 1963 fiscal year for offerings amounting to \$14.7 billion. This represents an increase of 2.8 percent in the number of statements filed and 26 percent in the dollar amount involved.

Of the 1,192 registration statements filed in the 1964 fiscal year, 322, or 27 percent, were filed by companies that had not previously filed registration statements under the Securities Act of 1933. Comparable figures for the 1963 and 1962 fiscal years were 357, or 31 percent, and 1,377, or 60 percent, respectively.

From the effective date of the Securities Act of 1933 to June 30, 1964, a cumulative total of 24,046 registration statements has been filed under the Act by 11,185 different issuers, covering proposed offerings of securities aggregating over \$258 billion.

Particulars regarding the disposition of all registration statements filed under the Act to June 30, 1964, are summarized in the following table:

[table omitted]

## **STOP ORDER PROCEEDINGS**

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

The following table shows the number of proceedings under Section 8 (d) of the Act pending at the beginning of the 1964 fiscal year, the number initiated during the year, the number terminated and the number pending at the end of the year.

[table omitted]

Three of the proceedings which were terminated during the fiscal year through the issuance of stop orders are described below:

**Advanced Research Associates, Inc.** -- In this proceeding, the Commission held that the company's prospectus was highly misleading and denied a request for withdrawal of the registration statement. The Commission found that despite certain caveats, the description of the issuer's business in the prospectus created a misleading impression of a company on the verge of major expansion and successful operation in the advanced electronic field in aviation, when in fact it had sustained substantial losses in its short history and future prospects were at best doubtful. The Commission pointed out, in this connection, that statements may be so distorted that no disclosure or caveat is sufficient to cure their misleading nature. The Commission also found a number of other deficiencies, including a misleading description of one of the company's products, a "Composite Transistor;" the failure to disclose that prior sales of the company's securities, claimed to have been made in reliance on certain exemptions from the registration provisions of the Securities Act, were in fact not exempt and violated those provisions, thereby giving rise to contingent liabilities; and a false statement that the certifying accountant was independent. The Commission's conclusion that the accountant was not independent with respect to the issuer was based on the fact that there had been a number of transactions and associations between him and two of the issuer's principals or companies in which they had a controlling or substantial interest.

**Atlantic Research Corporation.** -- The registrant, a Virginia corporation incorporated in January 1949, maintains its principal offices at Alexandria, Virginia, and has operations at various locations throughout the country. It is engaged primarily in research, development and manufacture in the field of solid propellant rockets. A large portion of its sales is generated pursuant to contracts and subcontracts for the United States Government. On July 31, 1962, registrant filed a registration statement covering a proposed offering of 179,000 shares of common stock for the account of certain stockholders.

Information developed by the Commission's staff in an investigation led to a suspension of trading in registrant's stock on October 10, 1962, because of serious questions as to the adequacy and accuracy of information available to the public concerning the financial condition of registrant. More specifically, unconsolidated financial statements contained in registrant's annual report to stockholders for the year ended December 31, 1961, reported profits on a parent only basis in the amount of \$1,473,192. Registrant filed

reports with the Commission covering the same period which showed a loss in the amount of \$1,066,015 on a consolidated basis.

Following the Commission's institution of stop order proceedings on November 7, 1962, registrant entered into a stipulation in which it waived a hearing and post-hearing procedures, and agreed that the registration statement was inadequate and inaccurate in certain respects and that the Commission might enter a stop order.

The Commission held that the registration statement was "marked by numerous serious and substantial deficiencies" which "reflected a studied pattern of corporate camouflage and concealment and of artificial market activities, all designed to present to investors and others a fictitious picture of registrant's activities and finances," and it issued a stop order. One of the principal deficiencies related to the failure to disclose registrant's relationships with certain "satellite" corporations. According to the opinion, registrant directed and completely dominated the management, policies and activities of these companies, which had no business activities of their own and were operated together with registrant as one economic unit. The failure to disclose these relationships resulted in the concealment of material aspects of registrant's financial affairs and business operations. Moreover, the Commission held, these satellites were in fact subsidiaries of registrant, and their financial statements should have been consolidated with those of registrant.

The Commission further found that the registration statement failed to disclose the true facts concerning the relationships between members of the management of registrant and certain landlord and other companies, and the interests of such persons in transactions to which registrant or its subsidiaries were parties. Disclosure in these respects would have raised further questions concerning the reliability of the financial statements in the registration statement. In addition, the registration statement failed to disclose the commitment of substantial amounts of registrant's capital to the acquisition of its own stock in the open market at a critical period in the market, for the purpose and with the effect of manipulating the market price and protecting the pledge by registrant's chief executive of his stock.

**South Bay Industries, Inc.** -- Registrant was incorporated in Delaware on August 3, 1959, for the purpose of acquiring 100 percent of the stock of two affiliated California corporations which were engaged principally in manufacturing ground handling equipment for aircraft and guided missiles. On December 11, 1959, it filed a registration statement covering a proposed offering of 210,000 shares of Class A common stock at \$5 per share. The registration statement became effective on March 23, 1960, and the offering was completed shortly thereafter.

On the basis of a stipulation of facts, the Commission found that the registration statement was materially deficient in failing to disclose current adverse financial information subsequent to the date of the most recent financial statements in the registration statement. A trial balance prepared prior to the effective date indicated a

substantial loss for one of the subsidiaries for its latest fiscal year. Under the circumstances, the Commission stated, registrant should at least have deferred the effective date of the registration statement until the imminent final audit figures were available. The Commission further found that even aside from the trial balance, registrant's president, the underwriter, and the certifying accountant were on notice prior to the effective date that the figures in the registration statement were out of date and that the registration statement gave no indication of registrant's subsequent adverse financial condition.

The Commission also found, among a number of other deficiencies, that the accountant who certified certain financial statements in the registration statement was not in fact independent with respect to registrant since, among other things, he and registrant's president were business associates in another, closely held company, and his conduct in permitting his certification to appear in the registration statement for financial statements which he knew were no longer representative of registrant's financial condition was not compatible with independence.

## **EXAMINATIONS AND INVESTIGATIONS**

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

[table omitted]

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

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

Rule 234: Exemption of first lien notes.

Rule 235: Exemption of securities of cooperative housing corporations.

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

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

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

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

Under Section 3 (c) of the Securities Act, which was added by Section 307 (a) of the Small Business Investment Act of 1958, the Commission is authorized to adopt rules and regulations exempting securities issued by a company which is operating or proposes to operate as a small business investment company under the Small Business Investment Act. Acting pursuant to this authority, the Commission has adopted a Regulation E which exempts upon certain terms and conditions limited amounts of securities issued by any small business investment company which is registered under the Investment Company Act of 1940. This regulation is substantially similar to the one provided by Regulation A adopted under Section 3 (b) of the Act.

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

### **Exempt Offerings Under Regulation A**

The Commission's Regulation A implements Section 3 (b) of the Securities Act of 1933 and permits a company to obtain needed capital not in excess of \$300,000 (including underwriting commissions) in any one year from a public offering of its securities without registration, if the company complies with the regulation. Upon complying with the regulation a company is exempt from the registration provisions of the Act. A Regulation A filing consists of a notification supplying basic information about the company, certain exhibits, and an offering circular which must be used in offering the securities. However, in the case of a company with an earnings history which is making an offering not in excess of \$50,000 an offering circular need not be used. A notification is filed with the Regional Office of the Commission in the region in which the company has its principal place of business.

During the 1964 fiscal year, 462 notifications were filed under Regulation A, covering proposed offerings of \$89,317,615, compared with 517 notifications covering proposed offerings of \$101,040,982 in the 1963 fiscal year. Included in the 1964 total were 26 notifications covering stock offerings of \$3,729,642 with respect to companies engaged in the exploratory oil and gas business, 11 notifications covering offerings of \$2,734,530 by mining companies and 22 notifications covering offerings of \$3,953,057 by companies featuring new inventions, products or processes.

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

[table omitted]

### **Suspension of Exemption**

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

During the 1964 fiscal year, temporary suspension orders were issued in 35 cases, which, added to the 27 cases pending at the beginning of the fiscal year, resulted in a total of 62 cases for disposition. Of these, the temporary suspension order was vacated in 8 cases and became permanent in 35: in 18 by lapse of time, in 6 by withdrawal of the request for hearing, and in 11 after hearing. Thus, there were 19 cases pending at the end of the fiscal year.

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

**Trail-Aire, Inc.** -- The issuer, a California corporation, was engaged in the design, rebuilding, manufacture, and sale of moving vans and trailers. Prior to the offering in question, the owners of its principal customers (the Dean group) purchased a 50 percent interest in the issuer for \$20,000. Shares representing this interest were issued to the attorney for the Dean group as holder of record and nominee for the group. However, the issuer's offering circular and notification listed the attorney as both beneficial and record holder of these shares. This procedure was claimed to be in the issuer's interest because its potential customers included competitors of the Dean group and it was felt a sales

problem might be created if it were publicized that the Dean group were the major stockholders of the issuer.

The Commission, in its order permanently suspending the Regulation A exemption,<sup>6</sup> stated that: "Even though the issuance of the Dean group stock in the name of a nominee for the beneficial owners may originally have been motivated by factors considered to be in the best interests of Trail-Aire, when the issuer undertook to make a public offering of its securities, disclosure of the facts as to the true beneficial owners of controlling blocks of stock was necessary. Particularly where such owners are the issuer's principal customers, the possibility exists that the issuer may conduct its affairs in a manner to serve their interests and to subordinate the other aspects of its business."

The Commission further stated that although there was no evidence indicating an intent to subvert the issuer's interests as a whole, the possibility of conflict was of vital interest to public investors, and they had a right to a full presentation of facts which indicated its presence and extent. The Commission concluded that the issuer's officers "exhibited a lack of concern for the complete truth and accuracy of the material filed and used, which is incompatible with the responsibilities of those who seek to avail themselves of the conditional exemption provided by Regulation A."

**Northeast Telecommunications, Inc.** -- In its Opinion and Order permanently suspending issuer's exemption, the Commission held, among other things, that no exemption under Regulation A was available because the \$300,000 statutory limitation was exceeded. While the offering consisted of 300,000 shares at \$1 a share, under the regulation 22,000 shares previously issued or sold had to be included in determining the aggregate offering price. These included 10,000 shares owned by officers and directors which had been placed in escrow, but which, pursuant to instructions from the issuer's president, were transferred by the escrow agent to a nominee of the underwriter 7 months prior to termination of the escrow agreement. The Commission stated that "where, as here, the president of an issuer participates with the escrow agent in a breach, of an escrow agreement the issuer cannot properly claim that 'effective' provision was made (as required by the regulation) to keep the stock in escrow. Moreover, it is immaterial that the underwriter did not sell the 10,000 shares until after the termination of the escrow agreement." The Commission also held that 12,000 shares sold in violation of the registration provisions of the Securities Act within 1 year prior to commencement of the Regulation A offering must be included in determining the aggregate offering price.

**Decorative Interiors, Inc.** -- The issuer offered its securities on a best efforts basis through an underwriter who was a sole proprietor whom it knew to be young, inexperienced, and financially irresponsible. When the Commission's staff began to inquire into the offering, questions were put to the underwriter, which he refused to answer and as to which he invoked the privilege against self-incrimination. The Commission then issued a temporary suspension order, based on Rule 261 (a) (7) which provides that an exemption may be suspended where-ever "the issuer or any promoter,

officer, director, or underwriter has failed to cooperate or has obstructed or refused to permit the making of an investigation by the Commission." At the hearing the issuer maintained that it had not been a party to the underwriter's failure to cooperate and asked for leave to substitute a new underwriter or to withdraw its filing. The Commission rejected the issuer's requests, held that the suspension must be made permanent, and said in its opinion:

"Since the offering was on a best efforts basis and the issuer did not intend to return any proceeds to investors if all the shares to be offered were not sold, the experience and responsibility of the underwriter were particularly important ... Under these circumstances, we think the issuer assumed whatever risks resulted from its action in employing this underwriter as its agent for the public sale of its securities. We think the record shows not only a lack of reasonable care on the part of the issuer in arranging for the selection of the underwriter and the terms of the offering, but also a failure to heed clear warnings of the underwriter's lack of responsibility and reliability."

### **Exempt Offerings Under Regulation B**

During the fiscal year ended June 30, 1964, 242 offering sheets and 290 amendments thereto were filed pursuant to Regulation B and were examined by the Oil and Gas Section of the Commission's Division of Corporation Finance. During the 1963 and 1962 fiscal years, 231 and 229 offering sheets, respectively, were filed. The following table indicates the nature and number of Commission orders issued in connection with such filings during the fiscal years 1962-64. The balance of the offering sheets filed became effective without order.

[table omitted]

**Reports of Sales.** -- The Commission requires persons who make offerings under Regulation B to file reports of the actual sales made pursuant to that regulation. The purpose of these reports is to aid the Commission in determining whether violations of laws have occurred in the marketing of such securities. The following table shows the number of sales reports filed under Regulation B during the past 3 fiscal years and the aggregate dollar amount of sales during each of such fiscal years.

[table omitted]

### **Exempt Offerings Under Regulation E**

Regulation E provides a conditional exemption from registration under the Securities Act of 1933 for securities of small business investment companies which are licensed under the Small Business Investment Act of 1958 or which have received the preliminary approval of the Small Business Administration and have been notified by the Administration that they may submit an application for such a license.

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

Regulation E provides for the suspension of exemption in particular cases if the Commission finds that any of the terms and conditions of the regulation have not been met or complied with.

There were no filings under Regulation E during the 1964 fiscal year.

### **Exempt Offerings Under Regulation F**

Regulation F provides an exemption from registration under the Securities Act for assessments levied upon assessable stock and for delinquent assessment sales in amounts not exceeding \$300,000 in any one year. It requires the filing of a simple notification giving brief information, with respect to the issuer, its management, principal security holders, recent and proposed assessments and other security issues. The regulation requires a company to send to its stockholders, or otherwise publish, a statement of the purposes for which the proceeds from the assessment are proposed to be used. If the issuer should employ any other sales literature in connection with the assessment, copies of such literature must be filed with the Commission.

During the 1964 fiscal year, 28 notifications were filed under Regulation F, covering assessments of \$835,623. Regulation F notifications were filed in three of the nine regional offices of the Commission: Denver, San Francisco and Seattle. Underwriters were not employed in any of the Regulation F assessments.

Regulation F provides for the suspension of an exemption thereunder, as in Regulation A, where the regulation provides no exemption or where the offering is not made in accordance with the terms and conditions of the regulation or in accordance with prescribed disclosure standards.

No Regulation F filings were temporarily suspended during the fiscal year 1964.

## **PART V**

### **ADMINISTRATION OF THE SECURITIES EXCHANGE ACT OF 1934**

The Securities Exchange Act of 1934, as amended by the Securities Acts Amendments of 1964 (enacted on August 20, 1964), provides for the registration and regulation of securities exchanges, the registration of securities listed on such exchanges, and under

new Section 12 (g), the registration of securities traded over the counter whose issuers have total assets in excess of \$1 million and a class of equity securities held of record by at least 750 persons (after July 1, 1966, the number will be reduced to 500). It establishes, for issuers of securities registered under the Act, financial and other reporting requirements, regulation of proxy solicitations and requirements with respect to trading by directors, officers and principal security holders. The Act also provides for the registration and regulation of national securities associations and of brokers and dealers doing business in the over-the-counter market, contains provisions designed to prevent fraudulent, deceptive and manipulative acts and practices on the exchanges and in the over-the-counter markets and authorizes the Federal Reserve Board to regulate the use of credit in securities transactions. The purpose of these statutory requirements is to ensure the maintenance of fair and honest markets in securities transactions on the organized exchanges and in the over-the-counter markets.

## **REGULATION OF EXCHANGES AND EXCHANGE TRADING**

### **Registration and Exemption of Exchanges**

As of June 30, 1964, 14 stock exchanges were registered under the Exchange Act as national securities exchanges:

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

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

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

## **Exchange Disciplinary Action**

Each national securities exchange reports to the Commission disciplinary actions taken against any member, member firm, or person connected therewith, for violation of any rule of the exchange, of the Securities Exchange Act of 1934, or of any rule or regulation thereunder. During the fiscal year 9 of the 18 exchanges reported 121 such actions, including imposition of fines ranging from \$50 to \$17,500 in 46 cases, with total fines aggregating \$63,000; the suspension from membership of 17 individuals and 7 member organizations; the expulsion of 6 individual members and 3 member organizations; and censures of 59 member organizations and individuals. Various other sanctions were imposed against registered representatives and other employees of member firms including the required re-examination of a number of prospective employees of member organizations.

## **Commission Inspections of the Exchanges**

The Commission is charged with the responsibility for the oversight of the national securities exchanges. In carrying out its duties in this regard and as part of its expanding program in this area, 9 inspections of the New York and American Stock Exchanges were made during the fiscal year. The major areas inspected included the exchange regulatory programs with regard to the financial responsibility of member firms; disciplinary actions; floor surveillance; and the handling of public complaints. In addition, general inspections were made of the Pacific Coast Stock Exchange, Midwest Stock Exchange and Spokane Stock Exchange.

## **REGISTRATION OF SECURITIES ON EXCHANGES**

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

Pursuant to Section 12 of the Exchange Act, an issuer may register a class of securities on an exchange by filing with the Commission and the exchange an application which discloses pertinent information concerning the issuer and its affairs. Information must be

furnished regarding the issuer's business, its capital structure, the terms of its securities, the persons who manage or control its affairs, the remuneration paid to its officers and directors, and the allotment of options, bonuses and profit-sharing plans, and financial statements certified by independent accountants must be filed as part of the application.

Form 10 is the form used for registration by most commercial and industrial companies. There are specialized forms for certain types of securities, such as voting trust certificates, certificates of deposit and securities of foreign governments.

Section 13 requires issuers having securities registered on an exchange to file periodic reports keeping current the information furnished in the application for registration. These periodic reports include annual reports, semi-annual reports, and current reports. The principal annual report form is Form 10-K which is designed to keep up-to-date the information furnished in applications filed on Form 10. Semi-annual reports required to be furnished on Form 9-K are devoted chiefly to furnishing mid-year financial data. Current reports on Form 8-K are required to be filed for each month in which any of certain specified events have occurred. A report on this form deals with matters such as changes in control of the registrant, important acquisitions or dispositions of assets, the institution or termination of important legal proceedings and important changes in the issuer's capital securities or in the amount thereof outstanding. Under the 1964 Securities Acts Amendments, the above requirements will be applicable to issuers registered under new Section 12 (g).

The following table shows the number of reports filed during the fiscal year pursuant to Section 13 of the Exchange Act and those filed under Section 15 (d) of the Act by issuers obligated to file reports by reason of having publicly offered securities registered under the Securities Act of 1933. As of June 30, 1964, there were 2,930 such issuers, including 290 that were also registered as investment companies under the Investment Company Act of 1940. The table also includes the number of annual reports, quarterly reports and reports to stockholders filed by issuers subject to the reporting requirements of Section 30 of the Investment Company Act.

[table omitted]

## **STATISTICS RELATING TO SECURITIES ON EXCHANGES**

### **Number of Issuers and Securities**

As of June 30, 1964, a total of 2,467 issuers had 4,076 securities listed on registered securities exchanges, of which 2,879 were stocks and 1,197 bonds. Of these totals 1,389 issuers had 1,611 stock issues and 1,115 bond issues listed and registered on the New York Stock Exchange. Thus, 56 percent of the issuers, 56 percent of the stock issues and 93 percent of the bond issues were listed on the New York Stock Exchange.

During the 1964 fiscal year, 138 issuers listed on registered securities exchanges for the first time, while the registration of the securities of 88 issuers were terminated. A total of 269 applications for registration of securities on an exchange was filed during the 1964 fiscal year.

### **Market Value of Securities Available for Trading, by Calendar Year**

The market value on December 31, 1963, of stocks and bonds, both listed and unlisted, admitted to trading on one or more stock exchanges in the United States was approximately \$561 billion.

[table omitted]

The New York Stock Exchange and American Stock Exchange figures were reported by those exchanges. There was no duplication of issues between them. The figures for all other exchanges were for the net number of issues appearing only on such exchanges, excluding the many issues on them which were also traded on one or the other of the New York exchanges. The number and market value of issues as shown excluded those suspended from trading and a few others for which quotations were not available. The number and market value as of December 31, 1963, of preferred and common stocks separately was as follows:

[table omitted]

The 3,041 preferred and common stocks represented over 9.8 billion shares, of which over 9.3 billion were included in the 2,823 issues listed on registered exchanges.

The New York Stock Exchange has reported aggregate market values of all stocks listed thereon monthly since December 31, 1924, when the figure was \$27.1 billion. The American Stock Exchange has reported December 31 totals annually since 1936. Aggregates for stocks exclusively on the remaining exchanges have been compiled as of December 31 annually by the Commission since 1948.

[table omitted]

### **Share and Dollar Volume and Market Value of Stocks Traded, by Fiscal Year**

The aggregate market values of all stocks available for trading on all exchanges as of June 30 annually, and the volume of shares actually traded on the exchanges in years ended June 30, have been as follows:

[table omitted]

The June 30 values were as reported by the New York Stock Exchange and as estimated for all other exchanges. Volumes included shares, warrants and rights. Tables 9 and 10 in the appendix of this Annual Report contain comprehensive statistics of volumes on exchanges.

Aggregate market values over the years are not strictly comparable, since they do not indicate what part of the change is due to factors such as new listings, mergers into listed companies, and removals from listing.

### **Foreign Stock on Exchanges**

The market value on December 31, 1963, of all shares and certificates representing foreign stocks traded on the stock exchanges was about \$14.3 billion, of which \$11.5 billion represented Canadian and \$2.8 billion represented other foreign stocks. The market values of the entire Canadian stock issues were included in these aggregates. Most of the other foreign stocks were represented by American depository receipts or American shares, only the outstanding amounts of which were used in determining market values.

[table omitted]

The number of foreign stocks on the exchanges has declined somewhat in recent years, owing principally to a reduction on the American Stock Exchange from 152 in 1956 to 106 in 1963. Trading in foreign stocks on the American Stock Exchange has fallen from 42.4 percent of the reported share volume in 1956, to 14.9 percent in 1963. Trading in foreign stocks on the New York Stock Exchange represented 3.4 percent of its reported share volume in 1956, and about 2 percent in 1963.

Reported volumes in foreign shares during calendar year 1963 included about 31 million Canadian and 16 million other foreign shares on the American Stock Exchange and about 10 million Canadian and 13 million other foreign shares on the New York Stock Exchange. While the share volume on the American exceeded that on the New York Stock Exchange, it would appear that in view of higher average share prices, the latter exchange had a greater dollar volume in foreign shares.

### **Comparative Exchange Statistics**

In recent years, the number of stocks listed on the New York Stock Exchange has increased moderately, while the aggregate number of stocks available for trading exclusively on the other exchanges has declined. On the American Stock Exchange there has been a small loss of issues since 1962.

[table omitted]

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

[table omitted]

The ratio of share volume on the regional exchanges to the total on all exchanges has continued to decline over the years. However, the regional exchange percentage of dollar volume has increased slightly. In the following presentation, shares, warrants and rights are included. Annual data since 1935 are shown in appendix table 10 in this Annual Report.

[table omitted]

## **DELISTING OF SECURITIES FROM EXCHANGES**

Applications may be made to the Commission by exchanges to strike any securities or by issuers to withdraw their securities from listing and registration on exchanges pursuant to Rule 12d2-2 under Section 12 (d) of the Securities Exchange Act. During the fiscal year ended June 30, 1964, the Commission granted applications by exchanges and issuers to remove 56 stock issues and 24 bond issues from listing and registration. Since 3 stocks were each delisted by two exchanges, there was a total of 59 stock removals. The number of issuers of stock involved was 48. The removals were as follows:

[table omitted]

In accordance with the practice in recent years, nearly all of the delisting applications were filed by exchanges. The two applications granted issuers during the year removed from the American Stock Exchange a Canadian stock with little trading volume and the stock of a domestic company which had incurred substantial losses.

The New York Stock Exchange delisted 21 bonds and debentures of German state, municipal and corporate issuers. On March 25, 1964, the Exchange adopted new delisting rules and criteria with respect to lack of earnings, limited distribution of securities and insufficient market value of outstanding stock and publicly held shares.

### **Delisting and Trading Suspension Proceedings Under Section 19 (a)**

Section 19 (a) (2) authorizes the Commission to suspend for a period not exceeding 12 months, or to withdraw, the registration of a security on a national securities exchange if, in its opinion, such action, is necessary or appropriate for the protection of investors and, after notice and opportunity for hearing, the Commission finds that the issuer of the security has failed to comply with any provision of the Act or the rules and regulations thereunder. Of the two proceedings under Section 19 (a) (2) pending at the beginning of

the fiscal year, one was terminated during the year, and no additional proceedings were instituted during the year.

In Precision Microwave Corporation the Commission found that a Securities Act registration statement, incorporated by reference in the issuer's application for registration of its common stock on the American Stock Exchange, contained false and misleading financial information, including a material understatement of liability for sales commissions, a material overstatement of work-in-process, and distorted comparative sales and earnings figures. It further found that the accountant's certificate was false and misleading because he did not follow generally accepted auditing procedures and was not in fact independent, having employed the office manager and accountant of the issuer's major subsidiary, who was responsible for maintenance of books and records reviewed during the audit, to assist him in the audit. The issuer had subsequently filed and submitted to stockholders an annual report for a more recent period which included financial statements audited by different accountants, but thereafter receivership proceedings and proceedings under Chapter XI of the Bankruptcy Act had been instituted with respect to the issuer, following which required reports were not filed. The Commission (in addition to issuing a stop order with respect to the registration statement) concluded to suspend the exchange registration of the stock for 60 days, with the proviso that if within 30 days the issuer filed reports containing correct up-to-date financial information and disclosing the status of the court proceedings and the extent of the present holdings and relationship to the issuer of the official principally responsible for the falsification of the financial information, and such reports presented a satisfactory basis for permitting the resumption of trading, the suspension would be terminated, but otherwise the exchange registration would be withdrawn. No reports were filed by the company and the registration of its stock was withdrawn.

Section 19 (a) (4) authorizes the Commission summarily to suspend trading in any registered security on a national securities exchange for a period not exceeding 10 days if, in its opinion, such action is necessary or appropriate for the protection of investors and the public interest so requires. During the 1964 fiscal year the Commission used this authority with respect to three companies. At the end of the fiscal year two suspensions remained in effect. A new Section 15 (c) (5) enacted as part of the 1964 amendments provides the Commission with authority summarily to suspend over-the-counter trading in any security for a period not exceeding 10 days if, in its opinion, the public interest and protection of investors so require.

## **UNLISTED TRADING PRIVILEGES ON EXCHANGES**

Stocks with unlisted trading privileges which are not also listed and registered on other exchanges continued to decline in number, from 168 on June 30, 1963 to 140 on June 30, 1964. The American Stock Exchange accounted for 24 of the 28 removals. The balance of the removals were accounted for by the Chicago Board of Trade, the Honolulu Stock

Exchange, and the Pacific Coast Stock Exchange. The distribution of unlisted stocks and share volumes therein among the exchanges is shown in appendix table 8. The statutory provisions regarding unlisted trading were amended in several respects after the close of the fiscal year by the Securities Acts Amendments of 1964.

The reported volume of trading on the exchanges in stock with only unlisted trading privileges for the calendar year 1963, was about 20,121,000 shares or about 1.1 percent of the total share volume on all the exchanges. About 93 percent of this volume was on the American Stock Exchange while three other exchanges contributed the remaining 7 percent. The share volume in these stocks on the American Stock Exchange represented 5.6 percent of the total share volume on that Exchange.

Unlisted trading privileges on exchanges in stocks listed and registered on other exchanges numbered 1,637 on June 30, 1964. The volume of unlisted trading in these stocks, for the calendar year 1963, was reported at about 62,258,000 shares. About 15 percent of this volume was on the American Stock Exchange in stocks listed on regional exchanges, and about 85 percent was on the regional exchanges in stocks listed on the New York or American Stock Exchanges. While the 62,258,000 shares amounted to less than 4 percent of the total share volume on all the exchanges, they constituted substantial portions of the share volumes on the leading regional exchanges, as reflected in the following approximate percentages: Boston 79 percent; Philadelphia-Baltimore-Washington 72 percent; Cincinnati 68 percent; Detroit 61 percent; Pittsburgh 54 percent; Midwest 32 percent; and Pacific Coast Stock Exchange 32 percent.

### **Applications for Unlisted Trading Privileges**

Applications by exchanges for unlisted trading privileges in stocks listed on other exchanges, filed pursuant to Rule 12f-1 under Section 12 (f) of the Securities Exchange Act, were granted by the Commission during the fiscal year ended June 30, 1964, as follows:

[table omitted]

The usual method of distributing blocks of listed securities considered too large for the auction market on the floor of an exchange is to resort to "secondary distributions" over the counter after the close of exchange trading. Secondary distributions, as reported since 1942, reached a peak of \$926,514,294 during the calendar year 1961, and totaled \$814,983,600 during 1963. During the first 6 months of 1964 there were 71 secondary distributions aggregating \$698,667,735 or 85.7 percent of the total for the entire year 1963.

In an effort to keep as much as possible of block business on their floors, Special Offering Plans were adopted by leading exchanges commencing in 1942, and the somewhat more flexible Exchange Distribution Plans commencing in 1953. Special

offerings have virtually disappeared, while the number of Exchange distributions has grown. The largest number of Special offerings was 87 in 1944, with \$32,454,000 aggregate value. In 1962, there were only 2 offerings and in 1963, there were none. In 1963, there were 72 Exchange distributions with a total value of \$107,498,026, a new high both in number and value.

[table omitted]

## **OVER-THE-COUNTER STATISTICS**

Based on information obtained from standard securities manuals and from reports to the Commission, there were, as of December 31, 1963, approximately 4,400 stocks of domestic issuers with 300 holders or more, possessing an aggregate value of about \$98.8 billion, which were quoted only in the over-the-counter market. They included \$26.7 billion in bank stocks, \$25.3 billion in insurance stocks, and \$46.8 billion in industrial, utility, and other miscellaneous stocks. The computation does not include securities issued by registered investment companies.

[table omitted]

In addition to the stocks mentioned above, there is a large number of actively quoted stocks of companies whose coverage by the standard securities manuals is generally limited to brief announcements of the circumstances of the offerings. Their number was in excess of 1,000 on December 31, 1963, at which time they constituted about 29 percent of the actively quoted stocks in the National Quotation Bureau services. These stocks may be presumed to have over 300 holders each. In addition, there is an indeterminate number of stocks with over 300 holders for the most part issued by small companies, which are inactively quoted or not publicly quoted. As far as can be ascertained, they are for the most part stocks of small companies.

A comprehensive view of the number of securities quoted over the counter at any one time is afforded by data supplied by the National Quotation Bureau, which is the principal publisher of over-the-counter quotations in the United States. The following table shows the number of stocks quoted in the daily service and the corresponding aggregate number of dealer listings, as reported for a day around January 15th annually.

[table omitted]

About half of the stocks show substantial concentration of dealer listings, including both bids and offers. Many of the remainder are quoted only on the bid side, indicating sporadic dealings. Some are listed on domestic or Canadian stock exchanges.

## **Reporting Under Section 15 (d)**

Issuers reporting pursuant to Section 15 (d) of the Securities Exchange Act continued to increase in number notwithstanding the numerous reductions occasioned by listing on the exchanges or absorption into other companies by purchase of assets or mergers. The number of such issuers increased from 2,647 on December 31, 1962 to 2,730 on December 31, 1963. The issued stock of 1,823 of these companies had a \$39.2 billion aggregate market value at the end of 1963. The remaining 907 issuers included partnerships, voting trusts duplicative of listed shares, stock purchase and employees savings plans, companies with only bonds in public hands, registered investment companies, and numerous issuers for whose shares no quotation was available, including a considerable number registering in 1963, but not offering their shares until 1964.

As amended by the 1964 Amendments, Section 15 (d) no longer requires registration statements filed under the Securities Act to contain an undertaking to comply with the reporting requirements of Section 13 of the Exchange Act under certain circumstances. That Section now automatically requires issuers filing registration statements to file reports under the Exchange Act during the year a registration statement becomes effective and thereafter if they have 300 or more security holders. Issuers required to register under Section 12 (g) will be required to file reports by virtue of being so registered.

[table omitted]

## **MANIPULATION AND STABILIZATION**

### **Manipulation**

The Exchange Act describes and prohibits certain forms of manipulative activity in any security registered on a national securities exchange. The prohibited activities include wash sales and matched orders effected for the purpose of creating a false or misleading appearance regarding the trading volume or market for a security; a series of transactions creating actual or apparent active trading in a security or raising or depressing its price, for the purpose of inducing purchases or sales of such security by others; circulation of information concerning market operations conducted for a rise or a decline in the price of a security; and the making of any materially false or misleading statement regarding a security for the purpose of inducing purchases or sales. The Act also empowers the Commission to adopt rules and regulations to define and prohibit the use of these and other forms of manipulative activity in any security registered on an exchange or traded over the counter.

The Commission's market surveillance staff observes the tickertape quotations of securities listed on the New York Stock Exchange and on the American Stock Exchange, the sales and quotation sheets of the various regional exchanges, and the bid and asked prices published by the National Daily Quotation Service for about 6,000 unlisted

securities to observe any unusual or unexplained price variations or market activity. The financial news ticker, leading newspapers, and various financial publications and statistical services are also closely followed.

In order to simplify recordkeeping and for other reasons it was decided that as of December 31, 1963, the "quiz" type of trading investigations would be discontinued and such cases assigned a standard case number. Such investigations are, and hereafter will be, included in the table entitled "Investigations of possible violations of the Acts administered by the Commission," which will be found under the heading COMPLAINTS AND INVESTIGATIONS in Part XI of this Report. However, 54 trading quizzes were pending at the end of the 1963 fiscal year, and 36 others were initiated prior to the change in policy, making a total of 90 such quizzes open at some time during the fiscal year. Only 35 of these remained open at the end of the fiscal year, 39 having been closed and 16 converted into investigations.

When a public distribution of securities is to be made, the markets in such securities are also closely watched to make sure that the price is not unlawfully raised prior to or during the distribution. During the fiscal year, 1,121 registered offerings, with a total offering price of \$16.9 billion, and 462 offerings exempt from registration under Section 3 (b) of the Securities Act, with a total offering price of \$89 million, were so observed. In addition, 232 other offerings, such as secondary distributions and distributions of securities under various plans filed by the exchanges, with a total offering price of \$1,284 million were also kept under surveillance.

### **Stabilization**

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

During fiscal year 1964 stabilizing was effected in connection with stock offerings totaling 38,358,692 shares having an aggregate public offering price of \$1,397,159,991 and bond offerings having a total offering price of \$235,434,000. In these offerings, stabilizing transactions resulted in the purchase of 788,712 shares at a cost of \$27,972,490 and bonds at a cost of \$2,837,165. In connection with these stabilizing transactions, 6,483 stabilizing reports, showing purchases and sales of securities effected by persons conducting the distribution, were received and examined during the fiscal year.

### **INSIDERS' SECURITY HOLDINGS AND TRANSACTIONS**

Section 16 (a) of the Securities Exchange Act is designed to prevent the unfair use of information by directors, officers and principal stockholders by giving publicity to their security holdings and transactions and by removing the profit incentive in short-term trading by them in securities of their company. Such persons by virtue of their position may have knowledge of the company's condition and prospects which is unavailable to the general public and be able to use such information to their personal advantage in transactions in the company's securities. Provisions similar to those contained in Section 16 of the Act are also contained in Section 17 of the Public Utility Holding Company Act of 1935 and Section 30 of the Investment Company Act of 1940.

### **Ownership Reports**

Section 16 (a), as it read during the fiscal year, required every person who was a direct or indirect beneficial owner of more than 10 percent of any class of any equity security (other than an exempted security) which was registered on a national securities exchange, or who was a director or officer of the issuer of such securities, to file reports with the Commission and the exchange disclosing his ownership of the issuer's equity securities, and to keep such information current.

After the close of the fiscal year, the Securities Acts Amendments of 1964 expanded the scope of Section 16 so as to apply to insiders connected with issuers which are required by Section 12 (g) to register securities traded over the counter with the Commission.

All ownership reports are available for public inspection as soon as they are filed at the Commission's office in Washington and those relating to securities registered on an exchange may also be inspected at the exchanges where copies of such reports are filed. In addition, for the purpose of making the reported information available to interested persons who may not be able to inspect the reports in person, the Commission summarizes such information in a monthly "Official Summary of Security Transactions and Holdings," which is distributed by the Government Printing Office on a subscription basis.

During the fiscal year, the number of ownership reports filed with the Commission reached an all-time high of 44,631 (6,573 initial statements of beneficial ownership on Form 3 and 38,058 statements of changes in beneficial ownership on Form 4). This represents an increase of 2,924 over the 41,807 reports filed during the 1963 fiscal year.

### **Recovery of Short-Swing Trading Profits by Issuer**

In order to prevent insiders from making unfair use of information which may have been obtained by reason of their relationship with a company, Section 16 (b) of the Securities Exchange Act, Section 17 (b) of the Public Utility Holding Company Act, and Section 30 (f) of the Investment Company Act provide for the recovery by or on behalf of the issuer of any profit realized by insiders from certain purchases and sales, or sales and purchases,

of securities of the company within any period of less than 6 months. The Commission has certain ex-emptive powers with respect to transactions not comprehended within the purpose of these provisions, but is not charged with the enforcement of the civil remedies created thereby.

## **REGULATION OF PROXIES**

### **Scope of Proxy Regulation**

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

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

The Securities Acts Amendments of 1964 extend the proxy solicitation requirements to those companies required to be registered under Section 12 (g) of the Act, and grant authority to the Commission to promulgate rules and regulations requiring an issuer to send information to security holders even though a proxy solicitation is not made, and requiring broker-dealers to transmit proxy material to customers.

### **Statistics Relating to Proxy Statements**

During the 1964 fiscal year, 2,530 proxy statements in definitive form were filed under the Commission's [Regulation 14 for the solicitation of proxies of security holders; 2,513 of these were filed by management and 17 by nonmanagement groups or individual

stockholders. These 2,530 solicitations related to 2,310 companies, some 220 of which had more than one solicitation during the year, generally for a special meeting not involving the election of directors.

There were 2,274 solicitations of proxies for the election of directors, 248 for special meetings not involving the election of directors, and 8 for assents and authorizations for action not involving a meeting of security holders or the election of directors.

In addition to the election of directors, the decisions of security holders were sought through the solicitation in the 1964 fiscal year of their proxies, consents and authorizations with respect to the following types of matters:

[table omitted]

### **Stockholders' Proposals**

During the 1964 fiscal year, a total of 211 proposals submitted by 45 stockholders were included in the proxy statements of 125 companies, pursuant to Rule 14a-8 of Regulation 14.

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

A total of 58 additional proposals submitted by 40 stockholders were omitted from the proxy statements of 36 companies in accordance with Rule 14a-8. The principal reasons for such omissions and the number of times each such reason was involved (counting only one reason for omission for each proposal even though it may have been omitted under more than one provision of Rule 14a-8) were as follows:

[table omitted]

### **Ratio of Soliciting to Nonsoliciting Companies**

Of the 2,467 issuers that had securities listed and registered on national securities exchanges as of June 30, 1964, 2,343 had voting securities so listed and registered. Of the latter group, 1,987, or 85 percent, solicited proxies under the Commission's proxy rules during the 1964 fiscal year for the election of directors.

### **Proxy Contests**

During the 1964 fiscal year, 18 companies were involved in proxy contests for the election of directors. A total of 225 persons, both management and nonmanagement, filed detailed statements as participants under the requirements of Rule 14a-11. Proxy statements in 12 cases involved contests for control of the board of directors and those in 6 cases involved contests for representation on the board.

Management retained control in 7 of the 12 contests for control of the board of directors and lost control in 1 contest, and 4 contests were still pending as of June 30, 1964. Of the 6 instances where representation on the board of directors was involved, management retained all seats in 5 instances, and in the remaining case the opposition won. 1 place on the board.

## **INVESTIGATIONS WITH RESPECT TO REPORTING PROVISIONS**

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

[table omitted]

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

### **Registration**

Section 15 (a) of the Securities Exchange Act of 1934 requires the registration of all brokers and dealers who use the mails or instrumentalities of interstate commerce to effect or induce transactions in securities in the over-the-counter market. Brokers and dealers conducting an exclusively intrastate business or dealing only in exempted securities, commercial paper, commercial bills or bankers' acceptances are exempt from registration. The 1964 Amendments added a Section 15 (a) (2) which permits the Commission to exempt broker-dealers or classes of broker-dealers, either unconditionally or upon specified terms or conditions, from the requirement of registration.

The following tabulation reflects certain data with respect to registrations of brokers and dealers during the fiscal year ended June 30, 1964.

[table omitted]

### **Administrative Proceedings**

Sections 15 (b) and 15 (A) of the Exchange Act were amended in several significant respects by the Securities Acts Amendments of 1964. Whereas under prior law the Commission could not proceed directly against an individual associated with a broker-dealer firm, but could take disciplinary action solely by proceeding against the firm, the Act, as amended, permits such direct action. The Commission may censure an associated person, may suspend or bar him from being associated with a broker or dealer, and may suspend or bar him from being associated with a member of a registered securities association. The sanctions which may be imposed against a broker-dealer now include censure and suspension of registration (for up to 12 months), in addition to the previously available sanctions of denial or revocation of registration and expulsion or suspension from a registered securities association or national securities exchange.

A sanction may be imposed upon a broker-dealer under Section 15 (b) if, after notice and opportunity for hearing, the Commission finds that such sanction is in the public interest and that the broker-dealer, or any person associated with such broker-dealer, is subject to one or more of the specified statutory disqualifications. A direct sanction against an associated person may be imposed where the Commission finds that it is in the public interest and that such person has committed or omitted any act or omission which would be a basis for the imposition of a sanction if such person were a broker-dealer. The statutory disqualifications, which have been enlarged by the 1964 Amendments, include the following:

- (1) willfully false or misleading statements in an application for registration or other report required to be filed under the Exchange Act;
- (2) conviction within the previous 10 years of a felony or misdemeanor which involved the purchase or sale of securities; arose out of the conduct of business as a broker-dealer or investment adviser; involved embezzlement, fraudulent conversion, or misappropriation of funds or securities; or involved violation of the provisions of the United States Code dealing with various frauds and swindles committed by use of the mails, telephone, telegraph, radio or television;
- (3) injunction by a court of competent jurisdiction against engaging in certain practices related to the securities business;

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

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

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

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

Set forth below are statistics with respect to broker-dealer proceedings instituted by the Commission during fiscal year 1964:

[table omitted]

### **Decisions of Particular Interest**

It is not feasible to summarize in this Report each of the many decisions rendered by the Commission in administrative proceedings with respect to brokers and dealers. However, several cases of unusual interest or significance, including some which involved procedural questions, are set forth in some detail in the following paragraphs :

On the basis of findings that they willfully violated the registration and anti-fraud provisions of the securities acts, the Commission revoked the broker-dealer registrations of Gearhart & Otis, Inc. and McCoy & Willard, expelled the former firm from membership in the National Association of Securities Dealers, Inc., and found the principals of each firm causes of the action taken against their respective firms. The Commission found that the respondents participated in the distribution of a control block of stock of Air America, Inc., which was not registered, that both firms were underwriters, and that their sales were therefore not exempt from registration. The Commission further found that in the offer and sale of Air America equipment trust certificates through Gearhart & Otis as underwriter, an offering circular was used which was misleading in that, among other things, it failed to disclose the company's precarious financial condition. In holding that Gearhart & Otis and its principals willfully violated the anti-fraud provisions in this connection, the Commission noted that Gearhart was intimately familiar with all significant developments relating to Air America, that Otis

was familiar with certain facts not properly disclosed in the offering circular, and that in any event the firm, as underwriter, and its principals owed a duty to the investing public to exercise reasonable care to assure the substantial accuracy of the offering circular. William D. McCoy, who was president of Air America as well as a partner of McCoy & Willard, and who played a leading role in the preparation of the offering circular, was also held to have willfully violated the anti-fraud provisions.

Among additional violations found with respect to Gearhart & Otis and its principals was a willful violation by Gearhart of Section 7 of the Securities Act (which specifies the information to be included in a Securities Act registration statement) in causing National Lithium Corporation to file a misleading and inadequate registration statement. The Commission noted that Gearhart, who signed the registration statement as a director and as attorney-in-fact for other directors, was primarily responsible for the terms of the contract leading to the creation of the company and was more familiar than anyone else with the facts relating to its promotion and preliminary financing. It held that as a director, and within the areas of his special knowledge, he was accountable for the deficiencies in the registration statement; and that as to those areas in which he did not have special knowledge, and where statements by an expert were not involved, he had a duty to make a reasonable investigation regarding the accuracy and adequacy of the information contained in the registration statement.

In *J. A. Winston & Co., Inc.* the Commission revoked the registration of the Winston firm and found its principal officials causes of the revocation, on the basis of findings that the respondents willfully violated the anti-fraud provisions of the securities acts. The Commission found that in the sale of stock of Gob Shops of America, Inc., respondents engaged in high-pressure sales tactics including the making of optimistic and flamboyant statements with respect to, among other things, the financial condition and future prospects of the issuer, which statements had no reasonable basis in fact. Respondents argued that any misrepresentations were made in good faith in reasonable reliance on information supplied to them by the issuer's officials. The Commission noted, however, that respondents did not see or request any current financial statements, and that the information assertedly given to them was of a general and unsubstantiated nature and did not provide a reasonable basis for the representations made by respondents. The Commission further found that respondents violated the anti-fraud provisions by selling securities at prices not reasonably related to prevailing market prices. It reaffirmed that in the absence of countervailing evidence, a dealer's own contemporaneous cost is the best evidence of current market price, and noted the fact that the registrant purchased securities from other dealers at prices around such other dealers' bid in the "sheets," thus demonstrating that the high asked quotations were not, as claimed, reliable evidence of prevailing market prices.

In *R. J. Hayes & Company, Incorporated*, the Commission denied the application for registration of a broker-dealer, whose president, Ralph J. Hayes, had willfully violated the anti-fraud and registration provisions of the securities acts while employed as a

salesman by another broker-dealer. His employer was the underwriter of a "hot issue" and Hayes, contrary to his employer's instructions not to purchase shares for his own account, opened fictitious accounts with the employer and with other firms and purchased and resold at a profit, shares of the "hot issue." The Commission found that his conduct constituted a fraud on his employer and the other firms.

In 1962, the Commission had issued an order suspending Amos Treat & Co., Inc., from membership in the National Association of Securities Dealers, Inc., for 12 months, pursuant to an offer of settlement. During the 1964 fiscal year, the Commission issued its findings and opinion in the case. It found that in the sale of securities of three different issuers, the firm's salesmen made various misrepresentations. With respect to one offering, as to which the registrant was managing underwriter, the Commission held that since the firm and its officers had actual knowledge that the issuer's financial condition, as reflected in the registration statement, was deteriorating, they should have exercised due diligence to ascertain current financial information, required its inclusion in the registration statement, and disclosed such information to the persons to whom they recommended the stock and made optimistic representations. The Commission again emphasized the responsibility of an underwriter to make a reasonable investigation into the issuer's business and the accuracy and adequacy of the information contained in the registration statement.

In A. T. Brod & Company the Commission, pursuant to an offer of settlement submitted by the registrant and Albert T. Brod, a general partner, and a stipulation and consent submitted by Martin Lesser, a former partner who was in charge of the firm's Washington, D.C. office, found that the respondents willfully violated the registration and anti-fraud provisions of the securities acts in connection with the offer and sale of unregistered shares of stock of Agricultural Research Development, Inc. (AGR). Among other things, Lesser arranged with a controlling person of AGR to place substantial amounts of AGR stock in an account with registrant and to sell substantial amounts to Lesser, for the purpose of distributing and trading in such stock. During the distribution, registrant purchased shares and placed quotations in the "sheets" at increasing prices and engaged in a telephone campaign to sell AGR stock. Respondents were also found to have willfully violated the record-keeping and credit extension provisions under the Securities Exchange Act. In imposing a 40-day suspension from membership in the National Association of Securities Dealers, Inc., on registrant, as contemplated by the offer of settlement, rather than a more severe sanction, the Commission considered a number of mitigating factors cited by the firm and Brod. Among other things, they asserted that Lesser initially acted with respect to the AGR stock without Brod's knowledge, and disobeyed subsequent instructions to discontinue transactions in such stock; that registrant had discontinued its relationship with Lesser, closed the Washington office, and arranged for restitution to customers who had purchased AGR stock; and that steps giving reasonable assurance of future compliance had been taken.

In Aircraft Dynamics International Corp. the Commission found that a broker-dealer firm, while acting as underwriter for a stock offering pursuant to Regulation A, committed various willful violations of the securities acts, and it revoked the firm's registration and expelled it from membership in the National Association of Securities Dealers, Inc. In the course of the offering, the firm's salesmen made various misrepresentations and employed other "boiler-room" techniques. The Commission held, among other things, that the firm's president and sole stockholder was responsible for the management of the business even if, as asserted, he did not take an active part in it. It further held that the sales manager was a participant in the violations, even if he himself did not offer or sell any of the stock, since by virtue of his position he assumed responsibility for the supervision of the salesmen, and the misrepresentations resulted from his failure to exercise that responsibility.

In Fred L. Carvalho, doing business as Capital Investment Company a salesman and public relations consultant for the registrant prepared a brochure used in the sale of securities, which, among other things, contained false and misleading projections of sales and earnings of the issuer and of the market price of the securities. The Commission rejected the salesman's defense that the financial data regarding the issuer had been supplied by the registrant, stating that "in the light of his own unsuccessful attempts to obtain current information directly from [the issuer] and his lack of knowledge of the company's status and affairs, his employment of data deliberately chosen from various sources to present a misleading and deceptive sales appeal-having no basis in fact was clearly fraudulent." The Commission also rejected the salesman's claim that he was not acting in the capacity of an employee when performing public-relations functions and that therefore no findings could be made against him. It noted that he was actively involved in the mailing of the brochure, was paid a weekly salary although he did not engage in sales during the period in question, and had no other place of business, and concluded that he was in fact an employee. The Commission revoked registrant's broker-dealer registration and found the salesman a cause of the revocation.

In Shiels Securities, Inc., the registrant and certain associated persons artificially inflated the price of securities by manipulative practices. Among other things, the registrant's president and controlling stockholder, who was also president and controlling stockholder of the issuer, caused the latter to declare a dividend during an offering of its securities through registrant as underwriter even though it had inadequate earned surplus; and following the completion of the offering, the registrant, which was the only dealer actively trading in the issuer's securities, purchased securities at prices which it arbitrarily fixed at successively higher levels. In addition, registrant further willfully violated the anti-fraud provisions of the securities acts by selling the securities to customers at successively higher prices without disclosing that the price had been artificially raised, and at excessive mark-ups, and by making materially false and misleading statements in connection with the offer and sale of the securities. The Commission concluded that it was in the public interest to revoke registrant's registration.

Advanced Research Associates, Inc. was a consolidated proceeding consisting of stop order and Regulation A suspension proceedings under the Securities Act of 1933, and broker-dealer proceedings with respect to four broker-dealers. Two of these, The First Washington Corporation and Williams, Widmayer Incorporated, had been organized by Don F. Widmayer and Richard N. Williams. The Commission found that First Washington, Widmayer and Williams, among others, willfully violated the registration provisions of the Securities Act in the sale of a large quantity of securities issued by Polytronic Research, Incorporated. Certain claimed exemptions, including those provided by Regulation A, the so-called "private offering" exemption, and the exemption provided by Rule 133 under the Securities Act, were held not to be available. The Commission further found that First Washington, aided and abetted by Widmayer and Williams, manipulated the market in Polytronic stock, by engaging in activities which inflated and maintained the market price of the stock at artificially high levels, failed to disclose such facts to purchasers and bid for and purchased Polytronic stock while engaged in a distribution of such stock; and that Widmayer and Williams were responsible for fraudulent statements in brochures regarding Polytronic which were distributed to First Washington's customers and for fraudulent representations by salesmen of that firm, and caused Advanced Research to file a false and misleading registration statement. The Commission revoked the registrations of the two firms and found Widmayer and Williams each a cause of such action.

The Commission addressed itself to the problem of unwarranted delay in the disposition of administrative proceedings in Herbert Rapp, doing business as Webster Securities Company. In that case, where it was alleged that registrant had failed to file required financial reports and was subject to two injunctions, when the hearing examiner arrived in New York City from Washington to convene the hearings as scheduled, counsel for the registrant advised him that he had just been retained solely to request an adjournment, but that he expected to represent registrant. The examiner granted a 10-day adjournment. Ten days later he again traveled to New York to reopen the hearings. At the reconvened hearings, both registrant and his counsel were present, but counsel requested a further adjournment, stating that registrant, because he had been ill with "flu", had been unable to reach counsel until that day. The hearing examiner granted a 2-hour adjournment, and denied requests for a further adjournment.

The Commission upheld his denial and his refusal to reopen the hearings for the presentation of evidence in defense and mitigation. Noting its continuing concern with the problem of delay in the disposition of administrative proceedings, the Commission stated that "Repeated adjournments granted pursuant to belated requests by neglectful parties not only cause undue interference with the hearing examiner's responsibilities and frustrate our efforts to avoid excessive delays, but unfairly deprive parties in other proceedings of an expeditious hearing."

In J. H. Goddard & Co., Inc., the Commission denied a motion to dismiss the proceedings and to dismiss allegations of violations of Rule 10b-6 under the Exchange Act. With

respect to the motion to dismiss the proceedings, the Commission rejected the claim that the institution of public rather than private proceedings denied movants due process. It stated that under the Exchange Act, the determination whether a proceeding shall be public or private rests in the discretion of the Commission, and it noted that in these proceedings there was a substantial public interest in the subject matter of the hearings; that certain allegations were already a matter of public record; and that public proceedings not only apprise investors of possible causes of action against broker-dealers prior to the running of the statute of limitations, but also enable them to institute such actions promptly before witnesses become unavailable. With respect to the second part of the motion, the Commission rejected the claims that Rule 10b-6 was so vague as to be violative of the due process clause, and that interpretation or revision of the rule in these proceedings would contravene the Administrative Procedure Act.

The principal question presented in *Siltronics, Inc.* was the admissibility in evidence against certain broker-dealer respondents of the record of prior consolidated proceedings to which they were parties and which had been terminated as to them without prejudice to the institution of new proceedings. In the prior proceedings, these respondents had claimed that under *Amos Treat & Co. v. S.E.C.*, termination was required because of participation in the proceedings by a Commissioner who had served as director of an operating division during its investigation of a stock offering by *Siltronics, Inc.* Although respectfully disagreeing with that decision, the Commission had terminated the proceedings. Thereafter, without the participation of the Commissioner in question, the Commission had instituted new proceedings based on the same and other charges, and had consolidated them with the prior proceedings against those respondents who had not requested termination.

The Commission held the prior record admissible, rejecting the contentions that, under the *Treat* case, a special "taint" attached to that record and that certain evidentiary requirements were not met. The Commission noted that no action by it had affected the evidentiary record. As to the second argument, the Commission pointed out that the rules of evidence in jury trials have no strict application to administrative proceedings; that there had been full opportunity for cross-examination as to those charges made in both proceedings, and that as to new charges, the staff's proposal to recall necessary witnesses at Government expense would fulfill the requirement for such opportunity; and that it was not a material objection to admissibility of the prior record that the witnesses might be available.

The Commission also denied motions by certain of the respondents to dismiss or to sever the new proceedings, based on the assertion that improper *ex parte* communications may have taken place between the Commission and the staff in connection with the termination of the prior proceedings and institution of the new proceedings, with respect to the inclusion of additional charges, the consolidation of the new proceedings with the unterminated proceedings and the offer in evidence of the record of the prior proceedings. The Commission pointed out that following termination, when it considered the

institution of new proceedings and consolidation, it was no longer acting in an adjudicatory capacity with respect to the respondents as to whom the proceedings had been terminated, and the separation-of-functions requirements of the Administrative Procedure Act were therefore not applicable.

### **Suspension of Registration**

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

### **Net Capital Rule**

The basic purpose of Rule 15c3-1, promulgated by the Commission under Section 15 (c) (3) of the Exchange Act, is to safeguard funds and securities of customers dealing with registered broker-dealers. This rule, commonly known as the net capital rule, limits the amount of indebtedness which may be incurred by a broker-dealer in relation to its capital. It provides that the "aggregate indebtedness" of a broker-dealer may not exceed 20 times the amount of its "net capital" as computed under the rule.

If it appears from an examination of the reports filed by a registered broker-dealer with the Commission, or through inspection of its books and records, that the ratio is exceeded, the Commission normally notifies the broker-dealer of the deficiency and affords an opportunity for compliance. Unless the capital situation is promptly remedied, injunctive action may be taken by the Commission and in addition proceedings may be instituted to revoke the broker-dealer's registration. During the past fiscal year, violations of the net capital rule were charged in 19 injunctive actions and in 24 revocation proceedings instituted against broker-dealers.

Registered broker-dealers who participate in "firm commitment" underwritings must have sufficient capital to permit the participation provided by the underwriting contract without impairing the capital-debt ratio prescribed by the rule. For the protection of issuers and customers of the broker-dealer, the Commission's staff carefully analyzes the latest available information on the capital position of the participants to determine whether they will be in compliance with the rule upon assumption of the new obligations involved in the underwritings. Acceleration of the effective date of registration statements filed under the Securities Act will be denied where underwriting commitments may engender violations of the net capital rule by any participating underwriter. A participant -found to be inadequately capitalized to take down his commitment is notified and given

an opportunity to adjust his financial position to meet the requirements of the rule without reducing his commitments. If he is unable to meet such requirements, he must decrease his "firm commitment" until compliance with the rule is reached. If necessary he may have to withdraw from the underwriting or participate on a "best efforts" basis only.

As a result of recommendations of the Special Study of Securities Markets, the Commission is presently in the process of formulating a proposed rule which would establish minimum net capital requirements for broker-dealers.

### **Financial Statements**

Rule 17a-5 under Section 17 (a) of the Exchange Act requires registered broker-dealers to file annual reports of financial condition with the Commission. Such reports must be certified by a certified public accountant or public accountant who is in fact independent, with certain specified limited exemptions applicable to situations where certification does not appear necessary for customer protection. Under certain, circumstances member firms of national securities exchanges are exempt from the necessity of certification and an exemption is available for a broker-dealer who, since his previous report, has limited his securities business to soliciting subscriptions as an agent for issuers, has transmitted funds and securities promptly, and has not otherwise held funds or securities for or owed monies or securities to customers. Also exempt is a broker or dealer who, from the date of his last report, has confined his business to buying and selling evidences of indebtedness secured by liens on real estate and has carried no margin accounts, credit balances or securities for any customers.

After his registration, a broker-dealer's first financial report must reflect his condition as of a date between the end of the 1st and 5th months after the effective date of the registration. All reports must be filed within 45 days after the date as of which the report speaks.

Through these reports the Commission and the public may evaluate the financial position and responsibility of broker-dealers. The financial report is one means by which the staff of the Commission determines whether the registrant is in compliance with the net capital rule. Failure to file the required reports may result in the institution of revocation proceedings. However, it is the policy of the Commission first to advise the broker-dealer of his obligations under the rule and to give him an opportunity to file the report.

During the fiscal year 4,503 reports of financial condition were filed with the Commission compared to the 1963 total of 5,197.

### **Broker-Dealer Inspections**

Section 17 (a) of the Exchange Act provides for regular and periodic inspections of registered broker-dealers. During the fiscal year the number of such inspections totaled

1,422. The inspection device is a most useful instrument in protecting investors and detecting violations of the Federal securities laws. The inspection, among other filings, determines a broker-dealer's financial condition, reviews his pricing practices, evaluates the safeguards employed in handling customers' funds and securities, and determines whether adequate and accurate disclosures are made to customers.

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

When inspections reveal that a broker-dealer is violating the statutes or rules, the action taken depends on the type of violation and its effect on the public. The Commission does not take formal action as a result of every infraction discovered. Inspections frequently reveal inadvertent violations which are discovered before becoming serious and before customers' funds or securities are in danger. "When no harm has come to the investing public the registrant is generally informed of the violations and advised to correct the improper practices. If the violation appears to be willful and the public interest is best served by formal action against the broker-dealer, the Commission will institute appropriate proceedings.

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

[table omitted]

The National Association of Securities Dealers, Inc., and the principal stock exchanges also conduct inspections of their members, and some states have inspection programs. Each inspecting agency conducts inspections in accordance with its own procedures and with particular reference to its own regulations and jurisdiction. Inspections by the Commission are primarily concerned with the detection of violations of the Federal securities laws and the Commission's regulations. The inspection programs of the self-regulatory agencies and of the states afford added protection to the public. The Commission and certain other inspecting agencies coordinate their inspections to avoid duplication and to obtain the widest possible coverage of brokers and dealers. Agencies now participating in this coordination program include the New York Stock Exchange, the American Stock Exchange, the Boston Stock Exchange, the Midwest Stock Exchange, the Pacific Coast Stock Exchange, the Philadelphia-Baltimore-Washington Stock Exchange, the Pittsburgh Stock Exchange, and the National Association of Securities Dealers, Inc. It is hoped that even closer coordination may become possible in the future as recommended by the Special Study of Securities Markets. This coordination,

however, does not preclude the Commission from inspecting any broker-dealer that has also been inspected by another agency, and such inspections are made whenever reason therefor exists.

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

Section 15A of the Securities Exchange Act of 1934 provides for the registration with the Commission of national securities associations and establishes standards for such associations. The National Association of Securities Dealers, Inc. (NASD) is the only association registered under the Act.

The Act contemplates that such associations will serve as a medium for the cooperative self-regulation of over-the-counter brokers and dealers. Their rules must be designed to protect investors and the public interest, to promote just and equitable principles of trade and to meet other statutory requirements. They are to operate under the general supervision of the Commission which is authorized to review disciplinary actions taken by them and other decisions which affect the membership of members, or of applicants for membership, and to consider all changes in their rules. The Securities Acts Amendments of 1964 significantly changed several statutory provisions regarding registered securities associations. Such associations are now required to adopt appropriate standards regarding the training, experience and other qualifications of members and persons associated with members; to have rules designed to produce fair and informative quotations of over-the-counter securities; and may bring disciplinary action directly against individuals associated with members.

In adopting legislation permitting the formation and registration of such associations, Congress provided an incentive to membership by permitting such associations to adopt rules which preclude a member from dealing with a nonmember, except on the same terms and conditions as the member affords the investing public. The NASD has adopted such rules. Accordingly, membership is necessary to the profitable participation in underwriting and over-the-counter trading since members may properly grant price concessions, discounts and similar allowances only to other members. Loss or denial of membership due to expulsion or suspension or other ineligibility due to a statutory disqualification, or to failure to meet standards of qualification established in NASD rules, thus imposes a severe economic sanction.

At the close of the fiscal year NASD membership was 4,158, reflecting a net decrease of 506 members during the year. This decrease was the result of 270 admissions to and 776 terminations of membership. During the year the registered representative population, which generally includes all partners, officers, traders, salesmen and other persons employed by or affiliated with member firms in capacities which involve their doing business directly with the public, declined by 9,540 to stand at 77,835 at June 30, 1964.

This shrinkage was the result of 8,175 initial registrations, 10,966 re-registrations and 28,681 terminations of registrations during the year.

In addition to its review of NASD rules and disciplinary actions, the Commission established during the year a program for periodic inspections of the Association's national and district offices. In fiscal 1964, the Commission staff conducted its first two district inspections which covered a broad range of subjects including surveillance and enforcement of association rules of conduct, the dissemination of quotations for local newspaper publication, and the organization of district business conduct committees.

### **NASD Disciplinary Actions**

The Commission receives from the NASD copies of its decisions in all disciplinary actions against members and registered representatives. In general, such actions are based on findings that the respondents violated specified provisions of the NASD's Rules of Fair Practice. Where violations are found the NASD may impose one or more sanctions upon a member, including expulsion, suspension, fine or censure. If an individual who is not a member is involved, his registration as a representative may be suspended or revoked, he may be suspended or barred from being associated with all members, and he may be fined or censured. Under Section 15A (b) (4) of the Exchange Act and the NASD's by-laws, no broker-dealer may be admitted to or continued in NASD membership without Commission approval, if he has been suspended or expelled from NASD membership; has been found to be a cause of certain sanctions imposed on a member; is subject to certain sanctions imposed by the Commission or a national securities exchange; or permits a person to associate with him who is subject to one of the above disqualifications, whose registration is suspended or has been revoked, or who is suspended or has been barred from associating with member firms.

During the past fiscal year the NASD reported to the Commission its final disposition in disciplinary complaint actions against 405 member firms and 372 registered representatives. With respect to 73 members, complaints were dismissed on findings that allegations of violations had not been sustained. [Footnote: The majority of the cases where allegations against members were dismissed involved misuse of customers' and/or firm securities or funds by a representative under such circumstances that the member could not have known of or prevented such impropriety. Association procedures did not, in this period, permit complaint action directed solely against a registered representative but required the naming of the employer-member as a respondent even though it was abundantly clear that the member was blameless.] In the remaining cases violations were found and some penalties were imposed on 332 members and 342 registered representatives or other individuals.

The maximum penalty of expulsion from membership was imposed on 73 different members and 16 members were suspended from membership for periods ranging from 15 days to 2 years. In many of these expulsion or suspension cases, substantial fines were

also imposed. In 194 cases the principal penalties imposed were fines ranging from \$25 to \$10,000. In 48 other cases the only sanction imposed was censure, although censure was often a secondary penalty imposed where a fine was the principal penalty imposed.

Various penalties were also imposed on registered representatives found in violation of the NASD's rules. The registrations of 132 representatives were revoked and 43 had their registrations suspended for periods ranging from 15 days to 2 years. In addition, 13 other individuals whose registrations were not revoked were found to have been the causes of the expulsion of 13 member firms and in one instance the cause of a 1-year suspension of a member. Allegations of violations against 30 representatives were dismissed on findings that no violation had occurred.

### **Commission Review of NASD Disciplinary Action**

Section 15A (g) of the Act, as amended, provides that disciplinary actions by the NASD are subject to review by the Commission on its own motion or on the timely application of any aggrieved person. This Section also provides that the effectiveness of any penalty imposed by the NASD is automatically stayed pending Commission review, unless the Commission otherwise orders after notice and opportunity for hearing. Section 15A (h) of the Act defines the scope of the Commission's review. If the Commission finds that the disciplined party engaged in or omitted such acts or practices as were found by the NASD, that such acts, practices, or omissions to act are in violation of such rules of the association as have been designated in the determination, and that such conduct was inconsistent with just and equitable principles of trade, the Commission must dismiss the review proceedings unless it finds that the penalties imposed are excessive or oppressive, having due regard to the public interest, in which case it must cancel or reduce such penalties. At the beginning of the fiscal year, 23 review proceedings were pending before the Commission; during the year 17 additional petitions for review were filed, decisions were issued in 18 cases, three petitions were withdrawn prior to determination, and 19 petitions were pending at the year end.

In its review of association disciplinary actions, the Commission issued several significant decisions during the year involving applications of the NASD mark-up policy.

In an important decision reviewing and reappraising the standards for determining the fairness under the NASD's mark-up policy of prices charged by broker-dealers, the Commission sustained the NASD's findings that Naftalin & Co., Inc. charged unfair prices in its sale of stock to customers and thus violated the NASD's Rules of Fair Practice. While sustaining the NASD findings of violations, the Commission reduced the penalty imposed against the firm from expulsion to a 20-day suspension from NASD membership, and the penalty against George E. Clark, a registered representative, from revocation of registration to a 20-day suspension. The Commission affirmed the NASD's censure of the firm and Clark and fines of \$4,500 and \$1,000, respectively, and found Neil T. Naftalin, president of the firm, a cause of the firm's suspension.

The NASD had found that the Naftalin firm as principal made 85 sales of Durox of Minnesota, Inc., stock to customers at prices ranging from 2% to 3%, and that such prices represented mark-ups of up to 28.5 percent over same-day costs and an average mark-up over cost on all sales of 17.9 percent. Such prices were found by the NASD to be in contravention of its Rules of Fair Practice which state that a member "shall observe high standards of commercial honor and just and equitable principles of trade" and require that where a member sells a security for his own account to his customer the price must be fair, taking into consideration all relevant circumstances, including market conditions, the expense involved, and the fact that the member is entitled to a profit.

Respondents contended that there were no violations because the firm's retail prices were identical with telephone quotations obtained prior to each sale from another dealer who was making a market in the stock. The Commission found, however, that the other dealer's telephone quotations were regularly subject to negotiation and therefore not reliable as a test of prevailing market price and that the firm's actual, contemporaneous costs were representative, and the best evidence, of the actual market in the Durox stock. The Commission stated:

"We note that the NASD mark-up policy expressly states that "[i]n the absence of other bona fide evidence of the prevailing market, a member's own contemporaneous cost is the best indication of the prevailing market price." The use of contemporaneous cost as an appropriate base upon which to compute mark-ups in retail transactions, "absent countervailing evidence," has frequently been recognized in our decisions and has been affirmed by the courts. This rule merely reflects a recognition of the fact that the prices paid for a security by a dealer in actual transactions closely related in time to his sales are normally a highly reliable indication of the prevailing market price. And the rule applies whether or not a dealer has a position in the security, unless it can be shown that the dealer's contemporaneous cost is not representative of the market price prevailing at the time of his sales. [Footnotes omitted]"

The respondents urged various considerations in mitigation of the penalties assessed against them. They asserted, among other things, that they acted in good faith, that any violations of the NASD rules were unintentional and due to lack of experience, the violations having occurred in the first few months of the firm's existence, and that the deficiencies were promptly corrected when called to their attention and did not recur. Respondents further urged that while some sanction may have been warranted, the firm was now a thoroughly responsible, professional and reputable concern, with qualified and trained personnel, which was worthy of continuing in the securities business, and that the public interest did not require or warrant expulsion, but at most a short suspension. Because of the mitigating circumstances, including the extensive efforts of the firm to remedy its initial shortcomings and to develop a qualified organization, equipped with adequate facilities and staffed by well-trained or experienced personnel, the Commission, concluded that reduced sanctions were appropriate in the public interest.

In another case involving findings by the NASD of excessive markups, the Commission sustained the NASD's action expelling General Investing Corporation from membership and revoking the registration of Ralph De Pasquale, its president, as a registered representative. The NASD found that the firm charged mark-ups ranging between 12.5 percent and 37.5 percent in 83 principal sales transactions. In 43 transactions the mark-ups were computed by the NASD on the basis of the firm's same-day cost, and in the remaining transactions on the basis of representative asked quotations in the National Quotation Bureau's daily sheets. The Commission rejected applicants' contention that with respect to 73 transactions involving 5 security issues the NASD should have computed mark-ups on the basis of the firm's own inside offer because the firm was the primary market maker, maintained a large inventory, and dominated the market in these securities, and the quotations of other dealers appearing in the sheets were unrealistic because these dealers were primarily interested in selling to the firm at its higher bid price.

While noting the problems pointed out by the Special Study of Securities Markets as to the proper base for calculating mark-ups with respect to retail sales by a sole or dominant market-maker, the Commission observed that if, as applicants contended, the firm was the primary market maker and dominated the market, to allow the firm to compute mark-ups on the basis of its own inside offer "when other firms are offering at wholesale prices lower than the firm's inside offer would make a sham of the protection intended by the NASD proscription that a member shall not charge unfair prices in principal transactions with customers." The Commission also noted that the evidence did not appear to support applicants' contention that other dealers were primarily selling to the firm and that, in any event, applicants had not contended that the quotations of other dealers were not bona fide prices at which they were willing to trade with other brokers and dealers. Applicants' contentions that their mark-ups were justified in view of the risk assumed in maintaining an inventory and the expenses incurred in selling these securities through extensive solicitation efforts were rejected by the Commission, which stated that "such factors do not justify retail prices higher than those at which the same securities are generally available to investors through other dealers who operate in the same market."

In *J. A. Winston & Co., Inc.*, another mark-up case, the NASD found that the firm effected 131 retail sales of Atlas Credit Corporation Class A stock and 563 retail sales of Atlas Class B stock at mark-ups-over its same-day cost of purchases from other dealers which averaged 26.5 percent and 33.5 percent for each class, respectively.

Respondents contended, among other things, that mark-ups in the Class B stock should have been computed on the basis of the firm's cost of purchases from retail customers, representing the large majority of its purchases, rather than on the lower cost of purchases from other dealers, and, as to the Class A stock, that they properly effected their retail sales at a price equal to or below the high independent asked price quoted in the "sheets." The Commission noted that the Winston firm throughout the period in question had

virtually complete control over purchase and sale prices, as well as supply and demand, of the Class B stock; that it was buying from other dealers at its own bid prices which it maintained below its retail purchase prices; and that, although it had a short position during most of the period, it was in a position to cover that position merely by adjusting its bid or by shifting the emphasis on retail solicitation from the sale to the purchase side. Under these circumstances, the Commission concluded that "there is little value in basing a determination of unfair pricing on a comparison or percentage relationship between resale prices and cost or any other single factor; it is more meaningful clearly to examine the prices actually charged in light of the surrounding circumstances and to determine whether those prices were fair." On the basis of the relevant factors, including the fact that "market" in the context of a pricing problem generally refers to the inter-dealer market, and the arbitrary pricing of the Class B stock above the independent market for the Class A stock, the Commission sustained the NASD's conclusion that the prices charged were excessive.

With respect to the Class A stock the Commission noted that "the great preponderance of numerical quotations on the offered side and the firm's ability consistently to make purchases ... from other dealers at prices below the quoted asked prices, make it clear that the quotations were regularly subject to negotiation and therefore not reliable as a test of the prevailing market price." It concluded that under the circumstances the firm's same-day cost in purchases from dealers was the best evidence of the inter-dealer market. In response to respondents' contention that the spread between their purchase and sale prices was not inconsistent with NASD-sponsored retail quotations on other securities published in newspapers, the Commission stated that "the difference, alone, between the bid and asked quotations cannot properly be treated as a measure of what is a fair or reasonable mark-up over contemporaneous cost."

The Commission also found that respondents willfully failed to register 141 salesmen and "contact men." It sustained the penalties imposed by the NASD of expulsion of the firm from membership and revocation of the registration of its principals.

In a proceeding involving mark-downs, the Commission sustained action by the NASD imposing a fine of \$500 against Thill Securities Corp. based on its findings that the firm purchased securities from customers at unfair prices in violation of the NASD Rules of Fair Practice.

In its decision the Commission disagreed with the position of the NASD that the best indication of the prevailing market price against which to measure the prices paid customers was the price realized by the firm in same-day resales to other dealers. Since the securities were not low-priced or speculative in nature, and had a competitive market and possessed a narrow spread between bids and offers, the Commission found that contemporaneous bid quotations obtained by the firm from dealers making the market were acceptable evidence of the prevailing market price. Based on such concurrent bids, the mark-downs ranged between 5 and 6 percent in eight transactions, between 4 and 5

percent in five transactions, and between 2 and 4 percent in four transactions. The Commission determined that it was "not prepared to disagree" with the NASD's conclusions that "in our experience industry practice does not warrant such mark-downs in the circumstances presented, even with the rendition of extraordinary service to customers."

### **Commission Review of NASD Action on Membership**

As previously noted, Section 15A (b) of the Act and the by-laws of the NASD provide that, except where the Commission finds it appropriate in the public interest to approve or direct to the contrary, no broker or dealer may be admitted to or continued in membership if he, or any person associated with him, is under any of the several disabilities specified in the statute or the by-laws. A Commission order approving or directing admission to or continuance in association membership, notwithstanding a disqualification under Section 15A (b) (4) of the Act, or under an effective association rule adopted under that Section or Section 15A (b) (3), is generally entered only after the matter has been submitted initially to the association by the member or applicant for membership. The association in its discretion may then file an application with the Commission on behalf of the petitioner. A broker-dealer, however, may file an application directly with the Commission either with or without association sponsorship. The Commission reviews the record and documents filed in support of the application and, where appropriate, obtains additional relevant and pertinent evidence. During the year eight such petitions were filed; five were approved; one was disapproved as discussed below; and two were pending at the end of the year.

The Commission disapproved a petition by the NASD that a member firm be continued in membership with Edgar R. D'Abre in its employ. The transactions giving rise to D'Abre's disqualification occurred in 1959, when D'Abre opened two accounts in a fictitious name and allocated shares of "hot issues" to those accounts, realizing profits of \$6,000 therefrom over a period of several months. When questioned by his then employer, he fabricated a credit report on the nonexistent customer but his explanation was unacceptable to the firm and he was discharged in August 1959. Following a hearing, at which D'Abre presented an elaborate explanation, an NASD District Business Conduct Committee concluded that the accounts were in fact D'Abre's, characterized his explanation as "preposterous," found that D'Abre had effected transactions in those accounts without the consent or knowledge of his employer, and revoked his registration as a registered representative.

Shortly before the decision was issued, D'Abre had obtained employment as a salesman for another firm; and thereafter proceedings were instituted before the NASD to determine whether the new employer should be continued in membership with D'Abre as an employee. Subsequently, an NASD application for approval of such continuance was remanded by the Commission 25 which expressed concern as to D'Abre's appreciation of "the professional obligation to his employer and to the public that further participation in

the securities field entails." After further hearings and consideration by the NASD, the latter renewed its application for approval.

In denying the second application the Commission stated, in part:

"The violations of NASD rules committed by D'Abre were of a serious nature, involving not only 'free riding,' but the manufacture over a period of several months of fictitious accounts and records and a false credit report, for the purpose of deceiving his employer and concealing violations of the restrictions upon transactions in new issues. This misconduct was compounded by D'Abre's concoction and presentation of false explanations to the NASD and his persistent failure to disclose the true facts. Only the pressure created by our remand and the ensuing hearing finally caused D'Abre to admit that the accounts were fictitious and to state that he regretted his violation of the trust that had been reposed in him. It was only after some prompting that, he admitted his profit motivation in maintaining the accounts. He stated that absent our remand and subsequent hearing, he probably would never have acknowledged the facts. That he made no further denials of his improprieties after the first District Committee decision or that he believed that the Committee members probably knew he had lied to them, cannot excuse his continued lack of candor."

The Commission concluded that these circumstances clearly demonstrated D'Abre's "unreliability and his lack of understanding of his obligation to his employer, to the District Committee, to the Board of Governors of the NASD and to the securities industry."

## **PART VI** **ADMINISTRATION OF THE PUBLIC UTILITY HOLDING COMPANY ACT** **OF 1935**

In administering the Public Utility Holding Company Act of 1935 the Commission regulates interstate public-utility holding-company systems engaged in the electric utility business and/or in the retail distribution of gas. The Commission's jurisdiction also extends to natural gas pipeline companies and other nonutility companies which are subsidiaries of registered holding companies. Although the matters under the Act dealt with by the Commission and its staff embrace a variety of intricate and complex questions of law and fact generally involving more than one area of regulation, briefly there are three principal regulatory areas. The first covers those provisions of the Act, contained principally in Section 11 (b) (1), which require the physical integration of public-utility companies and functionally related properties of holding-company systems and those provisions, contained principally in Section 11 (b) (2), which require the simplification of intercorporate relationships and financial structures of holding company systems. The second covers the financing operations of registered holding companies and

their subsidiaries, the acquisition and disposition of securities and properties, and certain accounting practices, servicing arrangements and intercompany transactions. The third includes the exemptive provisions of the Act, the provisions covering the status under the Act of persons and companies, and those regulating the right of a person affiliated with a public-utility company to acquire securities resulting in a second such affiliation. Matters embraced within this last area of regulation come before the Commission and its staff frequently. Many such matters do not result in formal proceedings and others are reflected in such proceedings only in an indirect manner when they are related to issues principally under one of the other areas of regulation,

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

## **COMPOSITION OF REGISTERED HOLDING-COMPANY SYSTEMS**

At the close of the fiscal year there were 24 holding companies registered under the Act. Of these, 18 are included in the 16 remaining holding-company systems which are herein classified as "active registered holding-company systems," 2 of the 18 being subholding companies in these active systems. The remaining 6 registered holding companies are of relatively small size and are excluded from the active holding-company systems. In the 16 active systems there are 84 electric and/or gas utility subsidiaries, 41 nonutility subsidiaries, and 12 inactive companies, or a total, including the 18 parent holding companies, of 155 system companies. The following table shows the number of holding companies and the number of subsidiaries (classified as utility, nonutility, and inactive) in each of the active systems as of June 30, 1964, and the aggregate assets of these systems, less valuation reserves, as of December 31, 1963.

[table omitted]

## **SECTION II MATTERS IN ACTIVE REGISTERED HOLDING-COMPANY SYSTEMS**

On October 10, 1983, a public hearing was held on Step 2 of a plan filed, pursuant to Section 11 (e), by Eastern Utilities Associates ("EUA") proposing the sale of all the outstanding common stock of Valley Gas Co., to the shareholders of EUA, and to the public common stockholders of Blackstone Valley Gas and Electric Co. ("Black-stone"), a subsidiary of EUA and the owner of all the outstanding common shares of Valley Gas Co. On March 3, 1964, the Commission issued its Findings and Opinion and Order approving Step 2 and, upon the request of EUA, an application for an order enforcing the plan was filed with the U.S. District Court for the District of Rhode Island. Following a hearing, at which a public stockholder of Black-stone appeared in opposition to the plan, the court approved Step 2 of the plan by order dated July 14, 1964. Upon its consummation, the separation of the gas utility properties from the EUA system will have been completed. Prior proceedings in this matter are discussed at page 109 of the 27th Annual Report.

In its Order of February 20, 1958, pursuant to Section 11 (b) (1), permitting retention by New England Electric System of all its electric properties, the Commission reserved jurisdiction to determine whether the system's gas properties were retainable under that Section of the Act. After further proceedings the Commission, on March 19, 1964, issued its Findings and Opinion and Order directing New-England Electric System to divest itself of all its interests in its gas properties. New England Electric System has filed a petition to review this order in the Court of Appeals for the First Circuit. At the close of the fiscal year the case was pending before the court.

The Commission has held, with court approval, that the existence of publicly-held minority interests in the common stock of subsidiary companies of registered holding companies constitutes an inequitable distribution of voting power requiring the elimination of such minority interests under Section 11 (b) (2). Through appropriate proceedings under the Act the Commission has heretofore ordered the elimination of public minority interests in most of the registered holding-company systems, but the problem remains in several others. During fiscal 1964, Allegheny Power System, a registered holding company, filed a plan, pursuant to Section 11 (e) of the Act, proposing the elimination of a 4.8 percent public minority interest in the common stock of its subsidiary company, West Penn Power Company, through the exchange of 1.7 shares of Allegheny Power's then \$5 par value common stock for each share of publicly-held West Penn common stock. The proposed exchange would involve the issuance of Allegheny's new common stock with an aggregate market value of approximately \$15,600,000 as of June 30, 1964. Public hearings on the plan were held during fiscal 1964; following the close of the fiscal year, the Commission approved the plan.

A Section 11 (b) (1) problem still exists as to whether Middle South Utilities, Inc. may, through its subsidiary company, New Orleans Public Service, Inc., retain its interest in the gas and transportation properties of that subsidiary company together with the system's electric properties. The electric properties of the Middle South system have heretofore been found by the Commission to constitute a single integrated public-utility system. On January 10, 1963, a bill was introduced in the Congress (H.R. 742, 88th Cong., 1st Sess.) providing, in effect, that New Orleans Public Service, Inc. shall not be required to dispose of its gas or transportation properties pursuant to any provision of the Public Utility Holding Company Act of 1935. At the close of fiscal 1964, the House Committee on Interstate and Foreign Commerce, to which the bill was referred, had taken no action thereon; and no proceedings have been instituted by the Commission.

## **EXEMPT HOLDING COMPANIES**

A "holding company" is defined by Section 2 (a) (7) (A) of the Act to mean any company which owns or controls 10 percent or more of the outstanding voting securities of an electric or gas public-utility company. Section 3 (a) of the Act provides that the Commission shall exempt any holding company (and its subsidiary companies, as such) from the duties and obligations of the Act if the company meets one or more of the exemptive standards set forth in that Section, unless the Commission finds that the exemption would be detrimental to the public interest. Such exemption may be granted by the Commission by order upon application, or (as to certain, types of exemption) may be claimed by the holding company by the filing in "good faith" of a statement pursuant to Rule 2 promulgated by the Commission under Section 3. At the close of the fiscal year statements submitted by a total of 55 holding companies under Rule 2 were on file with the Commission. Every initial Rule 2 statement and each annual statement renewing the claimed exemption is carefully examined by the Commission's Division of Corporate Regulation to ensure that the claimant is entitled to its asserted exempt status under Section 3 (a). In addition, six applications for exemption orders under Section 3 (a) were pending at the beginning of fiscal 1964, and five additional applications were filed during the fiscal year. The Commission issued orders granting exemptions to five of the applicants during fiscal 1964; and after the close of the year two additional exemption orders were issued.

Exempt holding companies are nevertheless subject to the provisions of Section 9 (a) (2) of the Act, which prohibits them from acquiring as much as 5 percent of the voting stock of any other public-utility company unless the acquisition has been approved by the Commission under Section 10. During the fiscal year, Cincinnati Gas & Electric Company (which claims exemption under Rule 2 as "predominantly a public-utility company") applied for and was granted authority to acquire the outstanding voting securities of two neighboring gas utility companies.

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

Pursuant to authorizations granted by the Commission under Sections 6 and 7 of the Act, nine registered holding-company systems issued and sold for cash to the public and to financial institutions 21 issues of long-term debt and capital stocks aggregating \$400 million in the fiscal year 1964. Seventeen of these issues were sold for the purpose of raising new capital. Of the remaining four issues, three were entirely or in part for the purpose of refunding \$38 million principal amount of outstanding debt securities carrying higher rates of interest and one was for the purpose of refunding \$6 million par value of preferred stock carrying a higher dividend rate.

The following table presents the amounts and types of securities issued and sold for cash by registered holding companies and their subsidiaries during fiscal 1964:

[table omitted]

The table does not include securities issued and sold by subsidiary companies to their respective parent holding companies, issuances of short-term notes to banks, portfolio sales by any of the system companies, or securities issued for stock or assets of nonaffiliated companies. These issuances and sales also required authorization by the Commission except in the case of the issuance of notes having a maturity of 9 months or less where the aggregate amount does not exceed 5 percent of the other securities of the company. Such exception is provided for by Section 6 (b) of the Act.

### **Competitive Bidding**

All of the 21 issues of securities sold for cash in fiscal 1964, as shown in the preceding table, were offered for competitive bidding pursuant to the requirements of Rule 50 promulgated under the Act.

During the period from May 7, 1941, the effective date of Rule 50, to June 30, 1964, a total of 884 issues of securities with aggregate value of \$13,127 million were sold at competitive bidding under the rule. These totals compare with 231 issues of securities with aggregate value of \$2,371 million which have been sold pursuant to orders of the Commission granting exceptions from the competitive bidding requirements of the rule under paragraph (a) (5) thereof. [Footnote: Paragraph (a) (5) of Rule 50 provides for exception from the competitive bidding requirements of the rule where the Commission finds such bidding is not necessary or appropriate under the particular circumstances of the individual case.] Of the total amount of securities sold pursuant to orders granting exceptions under this paragraph, 126 issues with a total value of \$1,888 million were sold by the issuers and the balance of 105 issues with a dollar value of \$483 million were

portfolio sales. Of the 126 issues sold by issuers, 70 were in amounts of from \$1 to \$5 million and two bond issues were in excess of \$100 million each.

## **PROTECTIVE PROVISIONS OF FIRST MORTGAGE BONDS AND PREFERRED STOCKS OF PUBLIC-UTILITY COMPANIES**

Statements of policy were adopted by the Commission in 1956 codifying the standards to which provisions covering first mortgage bonds and preferred stocks issued under the Act must conform for the protection of investors in such securities. Prior to 1956 these standards had been established by the Commission on a case-by-case basis. In passing upon the issuance of first mortgage bonds and preferred stocks under the Act, the Commission examines the applicable mortgage indentures and charter provisions to ensure a continuing substantial conformity with the codified standards of the respective statements of policy. Such conformity has been uniformly required except where, in particular circumstances, deviations from the statements of policy are clearly justified.

During the fiscal year, applications or declarations were filed by public-utility companies subject to the Act with respect to 14 first mortgage bond issues involving an aggregate principal amount of \$241,525,000, and 5 preferred stock issues with a total par value of \$34 million.

The statement of policy with respect to first mortgage bonds requires, among other things, that dividends or other distributions to common stockholders be limited so as to preserve an "equity cushion" beneath the claims of the bondholders. This requirement was adequately provided for in the indentures covering the 14 bond issues as filed or as a result of informal discussions between the Commission's staff and representatives of the issuers.

Since the bulk of bondholders' security consists of mortgaged depreciable plant and equipment, the statement of policy for bonds also requires the periodic renewal and replacement of such property so as to preserve the book value of the underlying security. This requirement, in substance, obligates the issuing company to provide for new property additions (or, alternatively, to deposit cash or outstanding bonds with the trustee) in an amount which, over the estimated, useful life of the mortgaged depreciable property, will maintain the original book cost of the mortgaged property. The statement of policy requires that the mortgage indenture express the periodic renewal and replacement obligation as a percentage of the book cost of the mortgaged depreciable property, but where existing indentures express the provision on some other basis (usually, as a percentage of operating revenues), such alternate provision is permitted to remain unchanged if the issuer can satisfactorily demonstrate to the Commission that the existing provision affords substantially the same protection as that based on a percent-of-property basis. To ensure observance of this standard of the statement of policy, the

Commission's staff conducts a continuous study of the depreciation requirements of the various issuers subject to the Act.

Of the 14 bond issues with respect to which applications or declarations were filed during the fiscal year, the indentures of 13 expressed the renewal and replacement provision as a percentage of depreciable property deemed adequate by the Commission. The remaining issue (bonds of a pipe line company) provided for a 100 percent amortization of the issue over its life through the operation of a cash sinking fund, and accordingly no renewal and replacement provision was deemed necessary for the protection of the bondholders.

With respect to the five preferred stock issues as to which applications or declarations were filed during the fiscal year, the existing charter provisions of all but one were in substantial conformity with the statement of policy for preferred stock; and as to the remaining issue, conformance with the statement of policy was effected through conditions imposed by order of the Commission.

In accordance with its long-standing policy under the Act, the Commission has continued to require that bonds and preferred stock sold by registered holding companies and their subsidiaries be fully refundable at the option of the issuer upon reasonable notice and that any redemption premium be reasonable in amount. During fiscal year 1964, as previously noted, three issuers subject to the Act took advantage of the refunding privilege and prevailing favorable market conditions to refund outstanding bonds at lower interest rates; and one issuer refunded a preferred stock issue at a lower dividend rate. The annual interest savings on the three bond issues refunded aggregated \$254,328; and the annual dividend savings on the preferred stock issue refunded were \$30,160. Had the outstanding issues been nonrefundable or severely restricted as to refundability, such savings could not have been effectuated.

Continuing studies made by the Commission's staff for fiscal year 1964 with respect to electric and gas utility bond issues sold at competitive bidding, whether or not subject to the Act, indicated that the presence or absence of a restriction on free refundability has not affected the number of bids received by an issuer at competitive bidding or the ability of the winning bidder to market the bonds. The 29th Annual Report, at pp. 85-86, noted that the data for fiscal year 1963 with respect to such ability on the part of the winning bidder were at variance with the data for prior fiscal years. That same report, at the pages referred to, contains a summary of the results of an examination of all electric and gas utility bond issues (including debentures) sold at competitive bidding between May 14, 1957, and June 30, 1963, by companies subject to the Act as well as those not so subject. This study was extended to include fiscal year 1964.

During the period from May 14, 1957 to June 30, 1964, a total of 466 electric and gas utility bond issues, aggregating \$10,401.9 million principal amount, was offered at competitive bidding. The refundable issues numbered 350 and accounted for a total of \$6,601.5 million, while the nonrefundable issues -- all being nonrefundable for a period

of 5 years, except one which was nonrefundable for a period of 7 years -- numbered 116 and totaled \$3,800.4 million principal amount. The number of refundable issues thus represented 75.1 percent of the total number of issues, while, in terms of principal amount, the refundable issues accounted for 63.5 percent.

The weighted average number of bids received on the refundable issues for the period was 4.72, while on the nonrefundable issues it was 4.19. The median number of bids was 5 on the refundable and 4 on the nonrefundable issues. With respect to the success of the marketing of the bond issues, an issue was considered to have been successfully marketed if at least 95 percent of the issue was sold at the syndicate price up to the date of termination of the syndicate. On this basis, 69.4 percent of the refundable issues were successful, while 65.5 percent of the nonrefundable ones were successful. In terms of principal amount, 66.1 percent of the refundable issues were successful, while 63.4 percent of the nonrefundable ones were successful. Extension of the comparison to include the aggregate principal amounts of all issues which were sold at the applicable syndicate prices up to the termination of the respective syndicates, regardless of whether a particular issue met the definition of a successful marketing, indicates that 86.0 percent of the combined principal amount of all the refundable issues were so sold, as compared with 82.2 percent for the nonrefundable issues. These aggregate statistics, as well as those relating to fiscal year 1964 noted in the margin, support the Commission's policy of requiring free refundability of utility bond issues subject to the Act.

## **OTHER MATTERS**

### **Request for Declaratory Order**

On May 26, 1963, a hearing was held with respect to an application filed by Pacific Northwest Power Company ("PNPC"), pursuant to Section 5 (d) of the Administrative Procedure Act, for a declaratory order requesting a determination as to when, in the construction of a proposed hydroelectric plant at an estimated cost of approximately \$260 million, the company would become an electric utility company within the meaning of Section 2 (a) (3) of the Act. PNPC's common stock is owned equally by Pacific Power and Light Company, Montana Power Company, Washington Water Power Company, and Portland General Electric Company. At such time as PNPC becomes an electric utility company within the meaning of the Act, its sponsoring companies become holding companies and, unless exempted, must register as such and comply with the requirements of the Act. On February 5, 1964, the Federal Power Commission granted a license to PNPC for construction and operation of the plant after a hearing in which the grant of the license was contested by certain public-utility districts. On March 3, 1964, this Commission issued a memorandum opinion and declaratory order, pursuant to Section 2 (a) (3) of the Act and Section 5 (d) of the Administrative Procedure Act, declaring that PNPC will not become an electric utility company within the meaning of Section 2 (a) (3) at least prior to the time at which the grant of the license by the Federal Power

Commission has become final, either by the expiration of the appeal period in respect thereof, or, in the event of an appeal, by the final determination of the appellate courts affirming the grant. The Commission expressly indicated that it was not then making a final determination as to the point in PNPC's development at which it would become an electric utility company under the Act.

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

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

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

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

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

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

## **SUMMARY OF ACTIVITIES**

In fiscal year 1964, the Commission continued to maintain a high level of activity under Chapter X. During the year, the Commission entered its appearance in 14 new proceedings involving companies with aggregate stated assets of approximately \$72 million and aggregate indebtedness of approximately \$70 million. These proceedings involved the rehabilitation of corporations engaged in various businesses including, among others, real estate and mortgage investments, vending machine manufacture and distribution, operation of hospitals and hotels, and manufacture of chemicals and electronic components.

During the year the Commission was a party in a total of 93 reorganization proceedings, including the new proceedings. The stated assets of the companies involved in these proceedings totaled approximately \$794 million and their indebtedness totaled approximately \$748 million. The proceedings were scattered among district courts in 30 states and the District of Columbia, as follows: 15 in New York; 10 in California; 9 in Florida; 6 in Illinois; 5 each in Kentucky and Michigan; 4 in Oklahoma; 3 each in Iowa, North Carolina, New Jersey, and Pennsylvania; 2 each in Arizona, Colorado, Montana, Maryland, Nevada, Texas, and Washington; and 1 each in the District of Columbia, Arkansas, Louisiana, Kansas, Ohio, Mississippi, Tennessee, New Mexico, Connecticut, Wyoming, West Virginia, Virginia, and Utah. Proceedings involving 6 principal debtor corporations were closed during the year. Thus, at the end of the year the Commission was participating in 87 reorganization proceedings.

## **JURISDICTIONAL, PROCEDURAL AND ADMINISTRATIVE MATTERS**

In Chapter X proceedings in which it participates, the Commission seeks application of the procedural and substantive safeguards to which all parties are entitled. The Commission also attempts in its interpretations of the statutory requirements to encourage uniformity in the construction of Chapter X and the procedures thereunder.

In Beehive Security Thrift & Loan, the district court granted the Commission's motion to enjoin a committee organized by a former employee of the debtor from soliciting funds from public investors. The Commission stressed, among other things, the dangers inherent in a committee's private assessment of public investors in light of the abuses prevalent in equity receivership proceedings prior to the reforms of Chapter X.

In Certified Credit Corporation, a committee was organized by certain of the debtor's former officers and directors and other stockholders to represent debenture holders and preferred stockholders in the proceedings. Some of the officer members were defendants in a class suit brought by other investors under Section 10 (b) of the Securities Exchange Act of 1934. Funds to defray expenses were solicited by the committee and were turned over immediately to its counsel who also represented defendant officers in the class suit. The Commission moved to disqualify the committee because of a conflict of interest and to compel a return of the funds solicited. Prior to a decision, the committee, pursuant to a stipulation, disbanded and agreed to return all funds collected.

In Joe Newcomer Finance Company, a debenture holders committee was enjoined, on motion of the Commission, from further soliciting contributions from public investors, and the funds already collected were ordered held in escrow pending a ruling on their disposition. In Goebel Brewing Company an order entered on the Commission's motion permanently restrained further solicitation of funds, approved the committee's accounting which showed that most of the solicited funds had been returned to investors, and reserved jurisdiction with respect to a small amount previously disbursed until a hearing on allowances. In Cosmo Capital, Inc., the committee voluntarily agreed to return the funds collected.

In Maryvale Community Hospital, Inc. the debtor, a charitable organization, objected to the filing of an involuntary Chapter X petition contending that, since under Section 4b of the Bankruptcy Act a charitable corporation may become a voluntary but not an involuntary bankrupt, the court did not have jurisdiction to approve the involuntary petition under Chapter X. In supporting the petition, the Commission urged that Section 4b was inapplicable to Chapter X, since Section 126 of that Chapter permits creditors to file a petition against a "corporation," defined in Section 106 (3) as any corporation "which could be adjudged a bankrupt ... ." The Commission also urged that Section 4b was intended to prevent liquidation in bankruptcy of a charitable corporation against its will, while Chapter X is designed for the financial rehabilitation, not the liquidation, of the debtor corporation. The court overruled the objection, and by order, without opinion, approved the petition.

In General Economics Corporation the same Chapter X trustees were appointed for the debtor and for its subsidiaries. Certain stockholders of one subsidiary, General Economics Syndicate, Inc. ("Syndicate"), moved to disqualify the trustees for this subsidiary on the ground that they were not disinterested within the meaning of Section 15 since they were also trustees for the parent and for another subsidiary against which Syndicate had possible claims. The Commission urged that a common trusteeship for the parent and subsidiaries was appropriate for the efficient administration of the estates; that such common trusteeship was contemplated by Section 129 which permits a subsidiary to file a Chapter X petition in the parent's Chapter X proceeding; and that separate trustees should not be required in the absence of a showing, on a complete record, that an actual and substantial conflict existed. The district court denied the stockholders' motion, and

the court of appeals affirmed on the basis of the arguments advanced by the Commission. The opinion of the court of appeals stated that its affirmance would not bar a similar motion in subsequent stages of the proceedings if a conflict in fact developed.

In Fleetwood Motel Corporation a landlord appealed from the district court's order denying his petition for possession of leased property on which the debtor had built a motel, its sole asset, at a cost of \$1,500,000. The lease provided for its termination upon the filing of a bankruptcy petition. While Section 70b of the Bankruptcy Act declares such a forfeiture provision enforceable in bankruptcy, and *Finn v. Meigham*, 325 U.S. 300 (1945) had held this provision applicable in Chapter X proceedings, the court of appeals as urged by the Commission, affirmed, stating that "... the question of enforceability of such a covenant is separate and distinct from the question whether enforcement in a particular case would be consistent with other provisions of the Bankruptcy Act." The court held that it would be inequitable to permit the landlord to secure possession of the debtor's principal asset as a result of the forfeiture and thereby defeat any possibility of a reorganization of the debtor in which the public had a substantial investment.

In Goebel Brewing Company the trustee recommended court approval of an offer to purchase substantially all of the debtor's assets. The court ordered the offer rejected, agreeing with the Commission that a sale which is tantamount to a liquidation should be made only pursuant to a plan. Subsequently, another offer for substantially all of the assets was incorporated in a plan which the court approved and confirmed. In *The Sire Plan, Inc.* the district court, over Commission objection, authorized the trustee to sell real estate and a seven-story steel structure thereon, owned by one of the debtor corporations. The court of appeals affirmed on the ground that a sale pursuant to a plan was not required for a partially constructed building, which the district court had found a "wasting asset."

In *Hughes Homes, Inc.*, the district court denied a motion of the parent's trade creditors that the separate corporate entities be disregarded and their claims be treated on a parity with the publicly held debentures of the subsidiary corporations. Committees for debenture holders and the Commission had opposed the motion. The trade creditors have appealed. [Footnote: In Its decision of September 21, 1964, the court of appeals affirmed, stating "... that the subsidiaries were operated as separate entities, that on balance the parent corporation was the beneficiary of the corporate interrelationship, that the objecting creditors did not rely upon the credit of the subsidiaries and were benefited rather than prejudiced by the way in which the subsidiaries were operated, that there was no fraud or overreaching attributable to" the subsidiaries and that "... there was no unjust enrichment of debenture holders" of the subsidiaries. *Anaconda Building Materials Co. v. Newland*, 336 F. 2d 625 (C.A. 9, 1964).]

In *Doctor's Hospital, Inc.* the debtor had sold to the public over \$1,600,000 of bonds, and, as a nonprofit corporation, its bond issue was exempt from the provisions of the Trust

Indenture Act of 1939. The debtor was reorganized as a for-profit corporation, which assumed the bonds with substantial modification of their terms. The reorganized company at first asserted that the assumption of the bonds under the plan did not involve a "sale" which required compliance with the Trust Indenture Act of 1939 but subsequently submitted the indenture for qualification.

## **TRUSTEE'S INVESTIGATION**

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

In Automatic Washer Company the court ordered, on petition of the trustee, which the Commission supported, that the stock interests of Bankers Life & Casualty Company and of Bellanca Corporation (presently Olson Brothers, Inc.) should be subordinated to the extent of \$1.50 per share of the publicly held stock of the debtor. Subordination was based upon wrongful transactions when each of these companies was the dominant stockholder of the debtor. Both companies have appealed.

In Equitable Plan Company the court authorized the trustee to accept \$600,000 in settlement of an action against Manufacturers-Hanover Trust Co. The trustee had alleged, inter -alia, that the bank improperly permitted Lowell M. Birrell and others to appropriate substantial sums from the debtor's bank accounts.

In Swan-Finch Oil Corporation the trustees settled their action against Manufacturers-Hanover Trust Co. for \$837,500, and Manufacturers withdrew its claim of \$8,300 against the debtor for services rendered as transfer agent. In their action the trustees alleged that Manufacturers, as depository, transfer agent and custodian for Swan-Finch, had, through negligence, aided and abetted Lowell M. Birrell in the illegal distribution of Swan-Finch stock. The settlement of the claim of Equitable Plan Company against Keta Gas & Oil Company, a subsidiary of Swan-Finch, provides that Equitable be paid \$87,500 in cash and retain 10.8 percent of the outstanding common stock of Swan-Finch. The trustees also settled for \$25,000 Keta's counterclaim against Doeskin Products Co., Inc., which has withdrawn its substantial claim against Swan-Finch.

## **REPORTS ON PLANS OF REORGANIZATION**

Generally, the Commission files a formal advisory report only in a case involving a substantial public investor interest and presenting significant problems. When no such

formal report is filed, the Commission may state its views briefly by letter, and authorize its counsel to make an oral or written presentation to amplify the Commission's views. During this fiscal year the Commission published one formal advisory report. The Commission conveyed its views to the court on 13 other plans, on some by oral statement of its counsel at the hearing, and on the others by letter and supporting memoranda.

The formal advisory report relates to Bevis Shell Homes Inc. which prior to the Chapter X proceeding was engaged in the construction and sale of shell homes. The plan is predicated in part on the possibility that the reorganized company may resume construction of shell homes or may acquire other types of operating companies under a program of general diversification.

It provides for the retirement of secured indebtedness of over \$5 million, held by institutional investors, out of proceeds to be realized from the liquidation of mortgages and houses in inventory. For the outstanding publicly-held debentures, totaling about \$2 million principal amount, the reorganized company would issue new debentures of the same principal amount, with interest reduced from 9 to 5 percent, and without compensation for past accruals of interest. The plan provides for the initial issuance by the reorganized company of about 1.5 million shares of common stock, 10 cents par value per share, of which 80 percent is to be distributed to the holder of a note for \$1.1 million which was subordinate to the debentures, and the balance, together with warrants, is allotted to the publicly-held common stock.

The Commission's report stated that the proposed building and diversification programs "are too vague and conjectural to be considered as a source of value or earnings for the reorganized company," and, insofar as predicated thereon, the plan is not feasible and, in fact, it "contemplates that these aspects of feasibility are not to be determined by the court but are to be deferred for decision by the management of the reorganized company," after the plan is consummated. The report further stated that it is not appropriate "under the auspices of the court to effect a public distribution of securities whose market prices may reflect in large measure uninformed or speculative appraisals of the conjectural possibilities to which, on this record, no credence can be given." Treating the plan as essentially a liquidation of present assets, the report also concludes that the plan is not fair and equitable since the debentures are not accorded full contractual right to interest, and since it provides participation for junior interests, including stockholders.

In TMT Trailer Ferry, Inc. as reported previously, the district court approved and confirmed an internal plan of reorganization, overruling objections by the Commission and the stockholders' committee. On appeal by the committee, which was supported by the Commission, the court of appeals postponed ruling on the issues on appeal, with the exception of the issue whether a plan may be confirmed which contemplates that the trustee will become president of the reorganized company. It held that the law does not preclude the employment of the trustee by the reorganized company. It stated, however, that the trustee would not be disinterested "... if the proponents of a plan assured him of

emoluments and security rather than merely nominating him for approval by the court and subject to the usual control of the Board of Directors."

## **ACTIVITIES WITH REGARD TO ALLOWANCES**

Every reorganization case ultimately presents the difficult problem of determining the allowance of compensation to be paid out of the debtor's estate to the various parties for services rendered and for expenses incurred in the proceeding. The Commission, which under Section 242 of the Bankruptcy Act may not receive any allowance from the estate for the services it renders, has sought to assist the courts in protecting debtors' estates from excessive charges and at the same time in allocating compensation equitably on the basis of the claimants' contributions to the administration of estates and the formulation of plans. During the fiscal year 205 applications for compensation totaling about \$5.4 million were reviewed. Two applications raised the question whether an allowance is barred because of a conflict of interest.

In St. John's View Sites, attorneys for holders of deeds of trust on the debtor's properties filed a series of suits for damages and other relief. Prior to the Chapter X proceeding, these attorneys secured a purchaser for the properties and thereafter the Chapter X proceeding was initiated apparently as the means for effectuating the sale and conveying clear title to the purchaser. By separate contract the purchaser was required to pay these attorneys \$10,000 as additional compensation for services to be performed in the Chapter X proceeding. This agreement was not disclosed to the court until sometime after confirmation of the plan of reorganization pursuant to which the properties were sold to the purchaser. The attorneys requested a fee of \$184,500, and the Commission recommended a fee of \$75,000 less the \$10,000 for an estimated 5,000 hours of compensable services before and during the Chapter X proceeding. Subsequently, the Commission filed a memorandum stating that the contract with the purchaser gave rise to a conflict of interest; that under *Woods v. City National Bank & Trust Co.*, 312 U.S. 262, 268 (1941), a conflict of interest is a bar to any allowance; and that some courts have indicated that in special circumstances a conflict of interest may be ground for reduction of an allowance. The special master recommended the full amount requested but, on exceptions filed by the Commission, the district court allowed \$100,000.

In Windermere Hotel Company, the Commission recommended that the attorneys for the plan proponent who was the purchaser of the property of the estate should be denied compensation because the interests of their client were adverse to the interests of the estate and of the bondholders who received the net proceeds of the sale. The court, however, awarded the attorneys compensation in the amount recommended by the special master whose report, adopted by the court, concluded that any conflict was practically eliminated since the property was sold at public auction in excess of its appraised value, and the plan proponent had dealt at arms-length with the trustee.

In Hudson & Manhattan Railroad Company in which the Commission submitted its recommendations in the previous fiscal year, the district court rendered its decision awarding, exclusive of interim allowances, final allowances totaling \$1,162,000 to groups of 30 applicants who had applied for compensation totaling \$2,441,000. The Commission had recommended allowances totaling \$1,183,000. The district court stated that it "... has, in accordance with the policy laid down by the courts, given great weight to the recommendations of the Securities and Exchange Commission as being an independent agency." The court also stressed the need for economy in the allowance of fees, stating: "In granting allowances in a situation such as this it is impossible to make allowances commensurate with fees which would be received in ordinary matters. Just as some of the creditors of the debtor had to take some loss, so the attorney and committees participating in the proceeding cannot be expected to be paid what they would be paid by an ordinary client."

Counsel for one of the committees requested an allowance of \$93,000, computed on the basis of \$50 per hour for partners and \$20 per hour for associates. The court, agreeing with the Commission's recommendation, allowed \$50,000, stating that the hourly rates proposed by the applicant were "... inappropriate for compensable services in a Chapter X proceeding." The court denied another applicant's request for \$6,000 and allowed \$4,000. The Commission had not objected to this application because the request was small but the court said that it did not believe "... that applications for high allowances should be approved merely because they constituted a 'small request'."

The court disallowed several applications, as recommended by the Commission, because of the bar under Section 249. That Section was held applicable to counsel for certain bondholders, where one of the firm's partners, as co-executor of his father's estate, had sold bonds of the debtor held in the estate and both partners of the firm were to share in the proceeds of the estate. However, the court awarded an allowance to co-counsel for the same bondholders in an amount recommended by the Commission, stating: "The Court agrees with the conclusion of the SEC that there was not that degree of intimacy among counsel that would call for this Court to bar compensation to co-counsel as well. .."

Of eight applications for leave to appeal, the courts of appeals granted two, which the Commission had supported, and these appeals were pending at the close of the fiscal year.

## **INTERVENTION IN CHAPTER XI PROCEEDINGS**

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

is amended to comply with the requirements of Chapter X, or a creditors' petition under Chapter X is filed.

In Canandaigua Enterprises Corporation the debtor and its subsidiary, Finger Lakes Racing Associates, Inc., which operate a horse race track in the Finger Lakes region of New York State, proposed an arrangement under which they would issue new 7 percent non-cumulative income debentures in exchange for the 7 percent fixed interest debentures held by the public. The new debentures would not have a sinking fund but would contain a more favorable convertible feature. The debtor's two classes of stock, 30 percent of which is owned by the debtor's officers and directors, would not be affected. The Commission's motion under Section 328 stated, inter alia, that the provisions of the proposed arrangement raised substantial questions as to fairness and equity with respect to the publicly-held debentures, which required the application of the procedural and substantive safeguards found only in Chapter X. The court denied the Commission's motion, and the Commission has appealed.

Motions under Section 328 were filed by the Commission and were granted in BarChris Construction Corporation<sup>38</sup> and Hydrocarbon Chemicals, Inc. In the BarChris case the debtor amended its petition to comply with Chapter X. In the Hydrocarbon proceeding the debtor similarly amended its petition after it withdrew its appeal from the order granting the Commission's motion. In Coast Investors, Inc., the debtor, after argument, consented to an order granting the Commission's motion and filed an amended Chapter X petition.

In American Trailer Rentals Company, discussed in the 29th Annual Report (p. 95), the district court's order denying the Commission's motion under Section 328 was affirmed by the court of appeals, and the Supreme Court granted the Commission's petition for a writ of certiorari. In Crumpton Builders, Inc. and American Guaranty Corporation, both summarized in the 29th Annual Report (pp. 95-96), the Commission appealed from orders denying its Section 328 motions. These appeals have been argued and are pending for decision. The Commission, by leave of court, withdrew its motion in Taste Freez Industries, Inc. after the receiver in the Chapter XI proceeding had disposed of a major part of the debtor's business.

## **PART VIII** **ADMINISTRATION OF THE TRUST INDENTURE ACT OF 1939**

The Trust Indenture Act of 1939 requires that bonds, notes, debentures and similar securities publicly offered for sale, except as specifically exempted by the Act, be issued under an indenture which meets the requirements of the Act and has been duly qualified with the Commission. The Act requires that indentures to be qualified include specified provisions which provide means by which the rights of holders of securities issued under

such indentures may be protected and enforced. These provisions relate to designated standards of eligibility and qualification of the corporate trustee to provide reasonable financial responsibility and to minimize conflicting interests. The Act outlaws exculpatory provisions formerly used to eliminate all liability of the indenture trustee and imposes on the trustee, after default, the duty to use the same degree of care and skill "in the exercise of the rights and powers invested in it by the indenture" as a prudent man would use in the conduct of his own affairs.

The provisions of the Trust Indenture Act are closely integrated with the requirements of the Securities Act. Registration pursuant to the Securities Act of securities to be issued under a trust indenture subject to the Trust Indenture Act is not permitted to become effective unless the indenture conforms to the requirements of the latter Act, and necessary information as to the trustee and the indenture must be contained in the registration statement. In the case of securities which, although exempted from the registration requirements of the Securities Act, are not exempted from the requirements of the Trust Indenture Act, the obligor must file an application for the qualification of the indenture, including a statement of the required information concerning the eligibility and qualification of the trustee.

[table omitted]

## **PART IX** **ADMINISTRATION OF THE INVESTMENT COMPANY ACT OF 1940**

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

The securities of investment companies which are offered to the public are also required to be registered under the Securities Act of 1933 and the companies must file periodic reports. Such companies are also subject to the Commission's proxy rules and closed-end companies are subject to "insider" trading rules.

## **COMPANIES REGISTERED UNDER THE ACT**

As of June 30, 1964, there were 731 investment companies registered under the Act, including 72 small business investment companies. Of this total, 617 were "active" companies, whose assets had an aggregate market value of approximately \$41.6 billion. Compared with the corresponding totals at June 30, 1963, these figures represent an overall increase of approximately \$5.6 billion in the market value of assets, while the number of registered companies increased by four. The classification of the registered companies and the respective approximate market values of the assets in each category as of June 30, 1964, are shown in the table on p. 111.

[table omitted]

The approximately \$2,856,000,000 of assets of the 107 "active" registered unit investment trusts includes approximately \$2,406,000,000 of assets of 54 registered unit investment trusts which invest in securities of other registered investment companies, substantially all of which are of the open-end type.

During the fiscal year, 52 new companies, including 2 small business investment companies, registered under the Act while the registrations of 48 companies, including 1 small business investment company, were terminated. The classification of these companies is as follows:

[table omitted]

## **GROWTH OF INVESTMENT COMPANY ASSETS**

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

[table omitted]

## **INSPECTION AND INVESTIGATION PROGRAM**

During the fiscal year 1964 a total of 146 investment company inspections was completed pursuant to the statutory authority conferred on the Commission by Section 31 (b) of the Investment Company Act. This represented a 76.5 percent increase over the 84 inspections of the previous fiscal year. These inspections were planned and supervised by the Branch of Inspections and Investigations which was established during fiscal 1963 in the Division of Corporate Regulation.

In furtherance of the Investment Company Act training program for staff members, short seminars on Investment Company Act problems and inspection techniques were conducted by members of the Branch of Inspections and Investigations at the regional offices in Denver, Seattle, Fort Worth, and Atlanta. A longer course was conducted at the Washington Regional Office in view of the expectation that increased responsibility for the investment company inspection program will be delegated to that office.

A large number of the inspections disclosed violations not only of the Investment Company Act but also of other statutes administered by the Commission. Although violations of the Investment Company Act which were uncovered were frequently of a relatively minor nature and were quickly corrected when called to the attention of the company involved, a number were more serious in character. These included inadequate arrangements for safekeeping of the investment company's portfolio securities or failure to observe the safekeeping procedures which had been established. In several instances, the fidelity bonds maintained by the investment company pursuant to Section 17 (g) of the Act were found to be inadequate in relation to the company's assets. In one instance it was found that the investment company did not in fact maintain an office at the address given in its prospectus as its head office, and that its books and records were being kept outside the United States. The inspections also disclosed several situations in which the procedures for pricing shares for purposes of purchase or redemption were not in conformity with the statute or the company's prospectus. Several instances were found in which investment company shares were not redeemed within the required statutory period. The inspections further exposed a number of instances in which transactions violating Section 17 of the Act were effected by affiliated persons.

Largely as an outgrowth of information obtained during the inspections, 33 private investigations were commenced during the fiscal year; and, on the basis of the facts obtained, five civil actions seeking injunctions, involving six investment companies, were instituted by the Commission. Two of these actions sought to enjoin further activity by unregistered investment companies. The complaint in one case (Max J. Royer) alleged violation of the proxy filing requirements of the Act, while in the other matter (Midland Basic) the complaint sought the appointment of a trustee and injunctions against two of the company's officers and directors for serving in those capacities while permanently enjoined by court order, in violation of Section 9 (a) of the Act. In connection with this matter, a subpoena enforcement action was instituted. In S.E.C. v. Continental Growth Fund, Inc., the complaint alleged, among other things, conversion, failure to maintain a fidelity bond, unlawful transactions with affiliated persons, and sale of shares at other than the current public offering price. In S.E.C. v. Fleetwood Securities Corporation, which involved a unit investment trust which had abandoned its duties as a depositor, the appointment of a receiver was requested. And in S.E.C. v. James J. Ling, et al. the complaint alleged, among other things, that affiliated persons of Electro-Science Investors, Inc., had entered into transactions with that investment company amounting to gross abuse of trust.

Settlements beneficial to shareholders of investment companies were obtained in two instances. In one, the investment company's president had, in effect, converted substantial sums due to failure of the bank which was custodian of the fund's assets to exercise minimal standards of custodial care. The settlement resulted in the return of approximately \$220,300 to the company. In the other instance, the principal underwriter and investment adviser for two registered investment companies had received substantial brokerage commissions on portfolio transactions which could have been executed directly without the payment of commissions, and transactions involving affiliated persons had been effected in violation of Section 17. As a result of administrative proceedings brought against the principal underwriter and investment adviser, a settlement was effected by which more than \$400,000 was returned to the two investment companies.

As a consequence of the training courses and the experience gained by participation in inspections and investigations, a number of the various regional offices of the Commission have assumed an increased responsibility in the inspection program as well as in the processing of formal investigations under the Investment Company Act.

### **SPECIAL STAFF STUDY OF INVESTMENT COMPANIES**

During fiscal year 1963 the Wharton School of the University of Pennsylvania submitted to the Commission its Study of Mutual Funds, which the Commission in turn submitted to the Committee on Interstate and Foreign Commerce, House of Representatives.<sup>7</sup> The Study, based on responses to questionnaires, constitutes the most comprehensive analysis of the mutual fund industry since the Commission's study made prior to the adoption of the Investment Company Act of 1940. It analyzes the growth, organization and control, investment policy and performance of open-end investment companies (popularly known as mutual funds), their impact on securities markets, the extent of control of portfolio companies, and the financial and other relationships of mutual funds with their investment advisers and principal underwriters.

As the Commission stated in its transmittal letter, many of the comments in the Study raise questions of broad policy whether some of the practices and patterns which originated in an earlier time and under different conditions and which have become conventional within the broad tolerances of the 1940 Act should be reconsidered. The study draws attention to the potential for divided loyalties arising from the typical structure of the industry under which a significant part of the funds' activities is performed by affiliated organizations such as advisers, underwriters, and brokers, who control or are represented on the boards of directors of the funds. Questions are also raised as to the relationship, or lack of relationship, between, on the one hand, the growth, size and performance of mutual funds, and, on the other hand, sales commissions, other sales incentives, advisory fees and costs of operation of the mutual funds and of the advisers, including fees charged by advisers to other clients. The Study comments upon

the role of and in general questions the effectiveness of "unaffiliated" directors of the typical mutual fund.

In forwarding the Study to the Congress, the Commission stated that it would be premature to attempt an evaluation of the conclusions in the Study, but that it was apparent that the Commission's rules under the 1940 Act and indeed some of the provisions of the statute itself might require reassessment. The Commission accordingly directed its staff to conduct a detailed evaluation of the Study with a view to making such recommendations as may seem appropriate.<sup>8</sup> This evaluation in which members of the staff of the Division of Corporate Regulation were engaged throughout fiscal 1964 includes a review of the structure and operations of the investment company industry generally, and a reassessment of the provisions of the Investment Company Act and the Commission's rules and regulations thereunder.

The Special Study of Securities Markets considered certain aspects of the investment company industry not covered by the Wharton School Study, namely, sales techniques, the adequacy of training and supervision of salesmen, "contractual" or "front-end load" plans for the purchase of investment company shares and the possible use of inside information with respect to portfolio transactions by those closely affiliated with investment companies. The conclusions and recommendations of the Special Study in these areas are contained in Chapter XI of the Special Study Report,<sup>9</sup> transmitted by the Commission to the Congress early in fiscal 1964. In one of the areas covered, that of contractual plans, the Special Study's Report suggested that the Commission recommend legislation amending the Act's provisions relating to such plans, that consideration be given to the abolition of any future front-end load or, if it should be concluded that abolition was not called for, that the legislation should both substantially limit the amount and method of application of any such load and prohibit the offering of front-end load contractual plans without the simultaneous offering of a level-load voluntary plan.<sup>10</sup> During fiscal 1964 the Association of Mutual Fund Plan Sponsors submitted to the Commission a statement in reply to the findings and recommendations of the Special Study regarding contractual plans. At the end of fiscal 1964 the Commission had this reply under consideration.

It is expected that the staff study will be completed during fiscal 1965, and that the staff's analysis, together with the reports of the Wharton School and of the Special Study of Securities Markets, will aid the Commission in determining whether to submit recommendations to the Congress for amendment of the Investment Company Act and what action, if any, should be taken to strengthen the rules and regulations under the Act.

## **CURRENT INFORMATION**

The Commission's rules promulgated under the Act require that the basic information contained in notifications of registration and in registration statements of investment

companies be kept current, through periodic and other reports, except in cases of certain inactive unit trusts and face-amount certificate companies. The following reports and documents were filed during the 1964 fiscal year:

[table omitted]

The foregoing statistics do not reflect the numerous filings of revised prospectuses by open-end investment companies and unit investment trusts making a continuous offering of their securities. These prospectuses, which must be checked for compliance with the Investment Company Act, are required to show material changes which have occurred in the operations of the companies since the effective date of the latest amendments on file.

## **APPLICATIONS AND PROCEEDINGS**

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

During the fiscal year, 245 applications filed under various sections of the Investment Company Act were before the Commission. The sections of the Act with which these applications were concerned and the disposition of such applications are shown in the following table:

[table omitted]

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

On June 18, 1964, the Commission issued noticed that Financial Industrial Fund, Inc. and Financial Industrial Income Fund, Inc. ("the funds"), two open-end investment companies, and Financial Programs, Inc. ("Programs"), had filed an application under Section 6 (c) for an order exempting them from the provisions of Section 15 of the Act to the extent that that section might be deemed to prevent Programs from serving as investment adviser of and principal underwriter for the funds.

Prior to the filing of the application, the Division of Corporate Regulation had conducted a private investigation, as a result of which it concluded that the investment advisory and principal underwriting contracts between Programs and the funds had been assigned, and therefore terminated, on or about January 2, 1964, as a result of the execution of certain contracts for the sale of approximately 87 percent of the voting and nonvoting stock of Programs, and the occurrence of certain related events.

While the application, did not concede the validity of the Division's position with respect to the assignment of the investment advisory and underwriting contracts, it proposed a basis for compromise of the matter involving the acceptance by Programs, subject to approval of the shareholders of the funds, of reduced fees based on the cost of rendering advisory and underwriting services for the period from January 2, 1964, to the date of the requested order. Shortly after the close of the fiscal year the application was granted by the Commission. [Footnote: On July 8, 1964, the Commission issued its Memorandum Opinion and Order (Investment Company Act Release No. 4009) granting the exemption sought by the application, conditioned on the approval by the shareholders of the funds of the modified payments by the funds to Programs. The Commission's opinion noted that the order did not "constitute authorization for the proposed payments or approval of the amounts thereof" but was "intended only to remove a possible statutory bar to consummation of the proposed compromise."]

As noted at p. 106 of the Commission's 29th Annual Report, on December 19, 1962, Randolph Phillips, a stockholder of Investors Mutual, Inc. and other registered open-end investment companies for which Investors Diversified Services, Inc. ("IDS") (also a registered investment company) serves as investment adviser, filed an application under Section 2 (a) (9) of the Act requesting a determination that Bertin C. Gamble, Gamble-Skogmo, Inc., and General Outdoor Advertising Company, acting collectively (referred to in the application as the "Gamble Group"), either alone or in concert with John D. Murchison, Glint W. Murchison, Jr. and others (referred to as the "Murchison Group"), had acquired control of Alleghany Corporation ("Alleghany"), and of IDS, about 47.5 percent of whose voting securities were owned by Alleghany. On January 2, 1963, the Commission ordered that a hearing be held with respect to these questions of control.<sup>13</sup> On February 15, 1963, IDS filed an application under Section 2 (a) (9) seeking determinations that (a) Murchison Brothers; (b) Allan P. Kirby, Sr.; (c) Kirby and certain associates; and (d) Murray D. Lincoln and/or companies controlled by or associated with him, controlled Alleghany and that Alleghany controlled IDS. This application was consolidated for purposes of hearing with the Phillips application. The hearings in these consolidated proceedings were concluded in September 1963, and in June 1964, the hearing examiner filed a recommended decision in which he determined, among other things, that the Gamble Group did not "control" Alleghany or IDS, as asserted by Phillips. Exceptions to the recommended decision were filed after the close of the fiscal year.

Hearings were reopened on an application originally filed in 1961 by International Bank, an Arizona corporation, for an order declaring, pursuant to Section 3 (b) (2) of the Act, that it was not an investment company. Although the Commission granted the application, it rejected applicant's contention that a company which owns securities as an incident to the operations of its majority-owned subsidiary and of its controlled companies is not "in the business" of owning and holding such securities and is therefore not an investment company within the definition of Section 3 (a) (3) of the Act. The Commission held that the section's applicability is not limited to situations where securities are held "merely as investments." However, the Commission concluded that applicant was primarily engaged in non-investment businesses and entitled to the order sought since (a) approximately two-thirds of applicant's total assets were represented by noninvestment businesses engaged in by it directly, through majority-owned subsidiaries, and through controlled companies conducting the business of banking, and (b) over two-thirds of its net income was derived from such businesses.

During the fiscal year, Townsend Corporation of America ("TCA"), and Townsend Management Corporation ("TMC"), both registered closed-end investment companies, sought an exemption pursuant to Section 17 (b) of the Act, and approval pursuant to Section 23 (c) (3), with respect to transactions incident to a plan of merger of TCA, TMC and Resort Airlines, Inc., all of which are affiliated companies. The plan grew out of a proceeding instituted by the Commission in the U.S. District Court for the District of New Jersey, in which the Commission alleged violations by TCA, TMC and certain controlling individuals of various provisions of the Act and sought injunctive relief and an order requiring that action be taken to effectuate compliance with the Act. The district court took possession of TCA and TMC for the purpose of enforcing compliance, enjoined the defendants from violations of the Act, appointed an interim board of directors to carry out the terms of its decree, and ordered that TCA and TMC, among other things, file with the Commission a plan of merger of TCA, TMC and Resort Airlines, Inc.<sup>18</sup> After a hearing, the Commission found, subsequent to the close of the fiscal year, that the terms of the merger plan were reasonable and fair and did not involve overreaching, that the transactions were consistent with the policies of the companies and the general purposes of the Act, and that the purchases by TCA and TMC of securities of which they were the issuers were to be made on a basis which would not unfairly discriminate against the holders of the classes of securities to be purchased. Accordingly, it granted the relief requested.<sup>19</sup> Upon the issuance of its order, the Commission, as had been directed by the district court, applied to that court for an order approving and enforcing the plan of merger.

**PART X**  
**ADMINISTRATION OF THE INVESTMENT ADVISERS ACT OF 1940**

The Investment Advisers Act of 1940 establishes a pattern of regulation of investment advisers similar to that contained in the Securities Exchange Act with respect to the conduct of brokers and dealers. With certain specified exceptions, the Act requires persons engaged for compensation in the business of advising others with respect to securities to register with the Commission, and requires investment advisers to conform to statutory standards designed to protect the public interest. The Act prohibits fraudulent conduct, and authorizes the Commission to define, and prescribe means reasonably designed to prevent, fraudulent, deceptive or manipulative acts or practices. Pursuant to such authority, the Commission has adopted a Rule (206 (4)-1) relating to advertising practices, which, among other things, proscribes the use of testimonials, circumscribes permissible references to past recommendations and the use of graphs and charts, and prohibits the use of false or misleading statements. Under another Rule (206 (4)-2), an investment adviser who has custody or possession of the funds or securities of clients must segregate them, maintain them in the manner provided in the rule and comply with certain other conditions.

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

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

### **Inspection Program**

During fiscal 1964, 239 inspections of investment advisers were completed by the Commission's staff (as compared to 219 the preceding year). These inspections disclosed a total of 182 indicated violations of the Act and the rules and regulations promulgated thereunder, as reflected in the following table:

[table omitted]

### **Administrative Proceedings**

The Commission instituted revocation proceedings against seven investment advisers during fiscal year 1964 and initiated two proceedings to determine whether applications for registration should be denied. During the year, it revoked the registrations of six advisers and denied one application. At the close of the fiscal year 13 revocation proceedings and 1 denial proceeding were pending. Those proceedings concluded during the year included the following:

**Anne Caseley Robin and Ben Robin, doing business as The Profit-maker** -- The Commission found, on the basis of stipulated facts, that Anne Robin, a registered investment adviser, violated the Act by failing to disclose in her registration application or by amendment that Ben Robin, her husband, exercised a controlling influence over the business. It further found that the Robins circulated misleading advertisements which represented that "The Profit-maker," a weekly market letter published by them, was staffed by trained and experienced securities analysts and experts, and that each stock discussed in the market letter had the potential of advancing 100 percent within a year. In addition, the Commission found that respondents engaged in fraudulent conduct by publishing an unverified and in fact false tip that a manufacturer, whose stock they recommended, had just received a large government contract. The Commission stated that advisers must meet the same "high degree of care required to insure accurate and adequate representations concerning securities discussed in printed advisory material distributed by a broker-dealer," and that if anything the deception was enhanced rather than dissipated by the use of a qualification at the end of the market letter that "information in this letter is not guaranteed but is gathered from sources we believe to be accurate." Revocation of registrant's registration was found to be in the public interest in view of the serious violations found.

**Justin Federman Stone** -- The Commission found that in the course of a publicity campaign designed to gain subscribers for Stone's advisory service, misrepresentations were made concerning the acceptance of the service by institutional investors. In addition, misleading statements were made to the effect that Stone's formula employed "miracle working computer-type techniques" resulting in "uncannily correct anticipation of market trends," and that the profitable results of the system had been proven by "exhaustive" tests. In concluding that Stone violated the anti-fraud provisions of the Act, the Commission noted that the publicity material conveyed the false impression that the advisory service provided an accurate mathematical device for determining when to buy and sell which had been proven by extensive tests and was widely acclaimed by experienced securities specialists and institutions. Stone's contention that the violations were attributable to his public relations counselor and therefore not willful was rejected, the Commission finding that Stone knew of and made no serious attempt to correct the

misrepresentations and failed to meet his responsibility to comply with the Act. The Commission concluded that it was in the public interest to revoke Stone's registration.

### **Registration Statistics**

At the close of the fiscal year 1,613 investment advisers were registered with the Commission. The following tabulation contains other statistics relating to registrations and applications for registration:

[table omitted]

## **PART XI** **OTHER ACTIVITIES OF THE COMMISSION**

### **CIVIL LITIGATION**

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

At the beginning of fiscal year 1964 there were pending in the courts 121 injunctive and related enforcement proceedings instituted by the Commission to prevent fraudulent and other illegal practices in the sale or purchase of securities. During the year 84 additional proceedings were instituted and 104 cases were disposed of, leaving 101 such proceedings pending at the end of the year. In addition the Commission participated in a number of corporate reorganization cases under Chapter X of the Bankruptcy Act, in 6 proceedings in the district courts under Section 11 (e) of the Public Utility Holding Company Act; and in 7 miscellaneous actions. The Commission also participated in 49 civil appeals in the U.S. courts of appeals. Of these, 17 came before the courts on petitions for review of administrative order, 12 arose out of corporate reorganizations in which the Commission had taken an active part, 12 were appeals in actions brought by or against the Commission, 1 was an appeal from" orders entered pursuant to Section 11 (e) of the Public Utility Holding Company Act, and 7 were appeals in cases in which the Commission appeared as amicus curiae. The Commission also participated in 8 appeals or petitions for writs of certiorari before the U.S. Supreme Court resulting from these or similar actions.

Complete lists of all cases in which the Commission appeared before a Federal or state court, either as a party or as *amicus curiae*, during the fiscal year, and the status of such cases at the close of the year, are contained in the appendix tables. This section describes a few of the more noteworthy cases, not including, however, cases arising under the Public Utility Holding Company Act or Chapter X of the Bankruptcy Act; cases arising under those statutes are discussed in the sections of this report dealing with such statutes.

In *J. I. Case Co. v. Borak* the Supreme Court, accepting the views urged by the Commission as *amicus curiae*, held that in a private suit based upon alleged violations of Section 14 (a) of the Securities Exchange Act and the proxy rules thereunder a Federal district court has jurisdiction to grant "all necessary remedial relief" and is not limited to the granting of "prospective" or declaratory relief as was held in *Dann v. Studebaker-Packard Corp.* Noting that the purpose of Section 14 (a) "is to prevent management or others from obtaining authorization for corporate action by means of deceptive or inadequate disclosure in proxy solicitation," the Court held that "it is the duty of the courts to be alert to provide such remedies as are necessary to make effective the congressional purpose." The Court also rejected the contention that a stockholders' derivative action may not be brought under the proxy rules, thereby implicitly overruling the decision in *Howard v. Furst* and indicated that the private right of action under the proxy rules may not be frustrated by such state law "hurdles" as security-for-expense statutes.

During the fiscal year, the Court of Appeals for the Third Circuit, in *The Prudential Insurance Company of America v. Securities and Exchange Commission* affirmed an order of the Commission declaring that the "Investment Fund" resulting from the proposed sale of variable annuity contracts by Prudential would be an investment company required to be registered under the Investment Company Act of 1940, notwithstanding the fact, that Prudential, as an insurance company, was excepted from the coverage of the Act. The court upheld the Commission's determination that the variable annuity contracts would constitute the purchasers thereof an "organized group of persons," that such contracts would create a "trust" held by Prudential for the purchasers and that the separate Investment Fund would be a "fund," all within the meaning of those terms as contained in the statutory definition of "company," and that the Investment Fund would be the "issuer" of the contracts for Investment Company Act purposes. It rejected arguments, among others, that the term "fund" referred only to recognizable business entities, that the existence in the Act of a specific exemption for common trust funds showed that regulation under the Act was imposed on an institutional rather than functional basis, and that the exemption for insurance companies was based upon the existence of adequate state regulation. The court concluded by stating that "the mere fact that the investment program in the case at bar is under the aegis of an insurance company ought not to negate compliance with [safeguards provided by the Act for investors in securities] in the absence of compelling circumstances."

Two cases, *Hersh v. Securities and Exchange Commission* and *Lite v. Securities and Exchange Commission* arose from an order issued by the Commission revoking the broker-dealer registration of J. Logan & Co., expelling the company from membership in the National Association of Securities Dealers, Inc., and finding that various officers and employees of the company, including Hersh and Lite, were each a cause of the revocation and expulsion. The Commission found that the company, aided and abetted by Hersh and Lite, had engaged in the practices of "churning" its customers' accounts and of "switching" securities back and forth between customers. The company had induced its customers to place complete reliance on it and its salesmen to act in the customers' best interests and had then taken gross advantage of the customers' trust and confidence by generating excessive transactions in their accounts and by recommending the purchase of a security to one customer while simultaneously persuading another customer to sell the same security, all in complete disregard of the financial welfare or investment aims of the customers, the objective being rather to produce brokerage fees and profits for the company and its salesmen. The Court of Appeals for the Ninth Circuit, holding that the findings as to Hersh were supported by substantial evidence, affirmed the order as to him on the basis of the opinion of the Commission. The court dismissed Lite's petition for review on the ground that it lacked jurisdiction over the subject matter by virtue of Lite's failure to urge before the Commission any of the objections raised in his petition.

In its motion to dismiss Lite's petition for review, the Commission had urged, as an alternative ground for dismissal, that the court lacked jurisdiction by virtue of Lite's failure to file his petition within 60 days after the "entry" of the Commission's order, as required by Section 25 (a) of the Securities Exchange Act. The court rejected that argument on the ground that the Commission does not maintain a court-type docket from which the precise date of the "entry" of its orders can be determined. The court apparently construed the Commission's Rules of Practice as requiring that such a docket be maintained. To avoid the uncertainty created by the Lite decision, the Commission subsequently amended its Rules of Practice.

In three cases this year, *Securities and Exchange Commission v. Bill Willoughby Coin Exchange, et al.*, *Securities and Exchange Commission v. Space City Investments, Inc., et al.*, and *Securities and Exchange Commission v. Comstock Coin Co., et al.*, the Commission sought injunctions against violation of the registration provisions of the Securities Act of 1933 in the offer and sale of investment contracts and certificates of interest and participation in profit-sharing agreements issued in connection with coin investment programs. The defendants had solicited funds from investors, agreeing to use the funds in the purchase and sale of coins and to share the profits derived therefrom with the investors. The defendants in all three cases consented to the entry of permanent injunctions.

The Commission filed a complaint against *Continental Growth Fund, Inc., et al.*, an investment company registered as such with the Commission, and certain of its officers and directors, seeking to enjoin the individual defendants from continuing to act as

officers and directors on the ground that they had been guilty of gross misconduct and gross abuse of trust. The Commission also asked for the appointment of a receiver for the firm's assets. The complaint charged, among other things, that Richard C. Jacobs, a promoter of the Fund and its former president and director, embezzled \$69,000 of the Fund's monies through a scheme by which he caused the Franklin National Bank as custodian to disburse monies for sham stock purchases by the Fund. The complaint also alleged that Jacobs caused the Fund to deviate from its stated investment policy, that the directors permitted the Fund to operate without a fidelity insurance bond to protect the Fund against larceny and embezzlement and without necessary books and records, that the net asset value at which it sold and redeemed its shares was improperly computed and that Jacobs sold securities to the Fund in violation of the Investment Company Act. The court appointed a receiver for the assets and property of the Fund and the remaining issues were pending at the close of the year.

The Commission filed a complaint against James J. Ling, Royce B. McKinley, and Joseph F. McKinney, former officers or directors, and Paul E. Brodrick, the present treasurer of Electro-Science Investors, Inc., an investment company registered as such with the Commission.

The complaint alleged, among other things, that Ling, with the assistance of the other defendants, took personal advantage of a corporate opportunity of the company to purchase and resell a large block of common stock of Tamar Electronics Industries, Inc., and that he realized substantial personal profits from the transaction which rightfully belonged to the investment company. The complaint seeks an order directing the defendants to account for and return such profits to the company and also seeks an injunction, pursuant to Section 36 of the Investment Company Act of 1940, preventing any of the defendants from serving in specified capacities for a registered investment company.

In *Securities and Exchange Commission v. United States Diversified Industries Corporation*, Jack Yetman and Leonard James, the district court issued a mandatory injunction directing the defendants to file with the Commission an annual report of the company for the year ended December 31, 1961. The common stock of the company was registered on the Pittsburgh Stock Exchange, a national securities exchange, until February 16, 1962, when it was delisted. The fact that the stock was delisted was held not to relieve the company of the obligation to file an annual report covering the last year during which the stock was still listed.

*Gils on v. Chock Full O'Nuts Corporation* was an action by a stockholder and his attorney seeking allowance of attorney's fees out of a fund paid to Chock Full O'Nuts Corporation by certain of its officers and directors in settlement of suits instituted against them by the corporation to recover "short-swing" trading profits pursuant to Section 16 (b) of the Securities Exchange Act. According to the complaint, the stockholder's attorney had investigated possible liability of the insiders to the corporation under Section

16 (b) and then had made demand on the corporation on April 10, 1962, that suit be instituted by May 31, 1962, as the statute of limitations would otherwise expire on June 2, 1962. After the corporation replied on April 16, 1962, that its preliminary investigation indicated that no violations had occurred, the stockholder's attorney prepared a complaint. On May 31, 1962, however, the corporation commenced actions against the insiders, resulting in the settlement. The district court granted defendant corporation's motion to dismiss, ruling that the awarding of attorneys' fees is limited to situations where the recovery to the corporation under Section 16 (b) has resulted from a suit successfully prosecuted by the stockholder.

A panel of the Court of Appeals for the Second Circuit, agreeing with the views expressed in a brief of the Commission filed as *amicus curiae*, reversed. After granting the corporation's petition for rehearing en banc, the full bench reversed the district court and held that an attorney who did "considerably more than simple preparation of the statutory request to the corporation to sue" was entitled to fees from the corporation after its successful suit. The court emphasized, however, that it was not deciding the question whether a stockholder's attorney is entitled to compensation from a corporation where he has done "nothing more than find a claim for the recovery of 'short-swing' profits under Section 16 (b) ... which the corporation then successfully brings at the stockholder's request."

In *Levitt v. Johnson* a stockholder of an investment company, Fidelity Capital Fund, Inc., brought a derivative action on behalf of himself, the Fund, and other similarly situated stockholders of the Fund against the Fund's directors, its corporate investment adviser, and its corporate underwriter. The complaint alleged *inter alia* (1) that the investment advisory fees had been and would continue to be "grossly excessive, unreasonable and illegal and out of proportion to the value of the services rendered" by the adviser and were a "waste and gift of the Fund's assets," in violation of Section 37 of the Investment Company Act and (2) that because of the degree of affiliation of the directors of the Fund with the directors of the adviser and the underwriter, the contracts and agreements for advisory and underwriting services, and all renewals and extensions thereof, were made in violation of Sections 10 (a) and 10 (b) of the Act and were thus null and void under Section 47 of the Act. The complaint stated that demand had not been made upon the directors of the Fund to bring this action, since they were to be named as defendants, nor had demand been made upon the stockholders, since that was assertedly unnecessary and futile for the reason, among others, that there were more than 48,000 stockholders scattered all over the United States and that to require demand upon these stockholders to take action would cast an unconscionable financial burden upon the plaintiff and would involve the conduct of a proxy fight entailing prohibitive expenses.

Motions to dismiss the complaint were filed by the defendants on the ground, *inter alia*, that the complaint failed to state a claim upon which relief could be granted. The District Court for the District of Massachusetts found that Rule 23 (b) of the Federal Rules of Civil Procedure had been complied with but dismissed the complaint for failure by

plaintiff to plead compliance "with the strict Massachusetts rule as to prior demand upon his fellow shareholders in Fund."

An appeal was taken from the district court's dismissal of the complaint and the Commission filed a brief amicus curiae in support of the appellant. The Commission took no position on the merits of the case. On July 8, 1964, the court of appeals, in vacating the judgment of the district court, held that demand upon the other stockholders of the Fund in the circumstances of this case would be a "pointless or, alternatively, impossibly burdensome act [and] ... should be excused." The court also held that the "strict Massachusetts rule" of demand upon stockholders would conflict with the broad declaration of policy contained in Section 1 (b) of the Act; it is therefore "the type of hurdle that the Investment Company Act ... forbids."

During the fiscal year the Commission was granted leave to participate amicus curiae in *Miller v. General Outdoor Advertising Corp., et al.*, a case involving the question of the applicability of Section 16 (b) of the Securities Exchange Act of 1934 to transactions involving the acquisition of options to purchase and sell securities of a class registered on a national securities exchange. The complaint in this case had alleged that the defendants and the Murchison Brothers, a partnership, had entered into a so-called agreement of put and call, whereby the defendants acquired the right to purchase from Murchison Brothers and Murchison Brothers acquired the right to sell to the defendants certain shares of common stock of Alleghany Corporation, and that within a 6-month period the defendants entered into a contract to sell the stock, thus giving rise to liability for profits under Section 16 (b). An appeal was taken from the order of the district court granting defendants' motion for summary judgment. The Commission filed a brief amicus curiae urging that the agreement of put and call constituted a purchase of the Alleghany common stock by the defendants against which a sale within a 6-month period could be matched for the purpose of determining liability under Section 16 (b). At the end of the fiscal year the appeal was still pending.

## **CRIMINAL PROCEEDINGS**

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

preparation of legal memoranda for use in the trial, the conduct of the trial, and the preparation of briefs on appeal.

During fiscal year 1964 the Commission referred 50 cases to the Department of Justice for prosecution. In the course of the year, 39 indictments were returned against 95 defendants in cases referred prior to and during the fiscal year, 2 criminal contempt actions were filed, and 93 convictions were obtained in 46 cases, while convictions were affirmed in 12 cases.

From 1934, when the Commission was established, until June 30, 1964, 3,408 defendants have been indicted in the U.S. district courts in 811 cases developed by the Commission and 1,774 convictions have been obtained. The record of convictions obtained and upheld in completed cases is over 84 percent for the 30-year life of the Commission.

As in prior years, the majority of the criminal cases prosecuted involved the offer and sale of securities by fraudulent representations and other fraudulent practices. These activities included high-pressure long-distance telephone "boiler-room" frauds, conversion of customers' funds and securities by broker-dealers or their salesmen, frauds involving the sale of securities by new as well as established businesses, and fraudulent securities sales in connection with the promotion of insurance companies, mortgage companies, oil and gas and other mining ventures, and other types of enterprises. It is not feasible to describe individually each of the many criminal matters pending during the fiscal year; however, two of the landmark criminal prosecutions which occurred during the year are discussed below.

On February 16, 1964, after 5 1/2 months of trial, Joseph Abrams, Sidney Albert and Richland Securities, a corporation controlled by Abrams, were found guilty by a jury of violating the registration provisions of the Securities Act of 1933 by offering and selling unregistered stock of Automatic Washer Company (United States v. Abrams, et al.).

In late 1955, defendants Abrams and Albert gained control of Automatic Washer Company by causing a corporation which they controlled to purchase 330,000 shares of Automatic Washer stock at a price considerably below the market price. Thereafter, they caused Automatic Washer Company to issue large blocks of stock to themselves and companies which they controlled in exchange for assets of little value. In this manner defendants obtained a total of 1,585,000 shares out of a total issued and outstanding of 2,155,594. At the trial it was proved that over 950,000 of the shares acquired by the defendants were sold to the public, commencing in January 1956, and continuing through October 1956. In addition, during the period Abrams and Albert distributed their Automatic stock on the Midwest Stock Exchange, the price rose from \$3 in December 1955, the date they obtained control, to \$9 in March 1956.

These convictions were obtained in spite of the fact that the defendants attempted to conceal their unlawful sales by utilizing many of the devices that have been frequently

employed to avoid the full disclosure requirements of the registration provisions of the Securities Act. For example, the defendants distributed a large number of shares to the public by permitting banks and brokerage houses to sell out Automatic Washer shares pledged by the defendants as collateral for loans which they had no intention of repaying. The defendants also attempted to disguise the distribution of their control stock by initially making purported "private sales" to various friends and relatives who acted as nominees or conduits. Although the shares so sold were immediately resold to the public, the defendants claimed that since they had made private placements to these "investors" they were not engaging in a public distribution of the stock. Finally, defendant Abrams also attempted to rely on a so-called "change of circumstances" as justification for the resale of the stock he had purchased from Automatic Washer Company.

The conviction of the defendants is significant in demonstrating that unscrupulous promoters cannot evade the registration requirements of the Securities Act by spurious reliance on exemptions from those requirements, and thereby deprive the investing public of full disclosure concerning the affairs of the issuer and its management.

The convictions of Roy B. Kelly, Cecil V. Hagen, Milton J. Shuck and Gulf Coast Leaseholds, Inc., in *United States v. Van Allen, et al.*, are also significant. These defendants, nine other individuals, and eight corporations were charged with violating and conspiring to violate the anti-fraud and registration provisions of the Securities Act of 1933 and the mail and wire fraud provisions of Title 18 of the U.S. Code in connection with the offer and sale to the public of Gulf Coast Leaseholds, Inc., stock.

Evidence adduced during the trial showed that Gulf Coast Leaseholds, Inc., was a small and unprofitable oil company controlled by Hagen and Kelly. In September 1954, after unsuccessfully attempting to obtain an underwriter for a Gulf Coast Leaseholds stock offering, Hagen and Kelly were introduced to John Van Allen. Although Van Allen's Lichtenstein investment company, Brandel Trust, had only \$20.80 in its bank account, he agreed to have it purchase 750,000 shares of Gulf Coast Leaseholds stock for approximately \$1,300,000.

Using Brandel Trust as a conduit, Van Allen began distributing Gulf Coast Leaseholds stock to the American public even before the deal was closed, using the proceeds from these sales to take delivery of each successive block of stock from Hagen and Kelly. Facilitated by the dissemination of false and misleading information furnished by Hagen and Kelly, the distribution of the 750,000 shares to the public was completed by September 1955, at prices ranging up to \$15 a share. When the deal was closed the previous year the stock had been selling at between \$1.25 and \$1.50 per share.

Subsequently, Kelly and Hagen caused \$2 million of Gulf Coast Leaseholds debentures to be issued to Van Allen. However, these debentures which were convertible into common stock at the rate of \$8 a share could not be resold until after November 17, 1956, because they were purportedly purchased for investment and bore a restrictive legend.

Accordingly, the defendants, in order to maintain the market above the conversion price until that time, were forced to purchase Gulf Coast Leaseholds stock on the open market. This stock was resold to investors through two boiler-rooms owned by the defendant Shuck. The experienced salesmen employed by Shuck utilized every high-pressure device to induce unwary investors not only to purchase this stock, but to hold it, thereby reducing the floating supply of stock on the market.

Eight of the defendants pleaded guilty before or during the trial and others were severed for trial. The trial, which began in November 1962, and continued until August 8, 1963, produced a transcript containing nearly 18,000 pages of testimony and over 1,000 exhibits. On October 8, 1963, the court sentenced the defendants to imprisonment totaling 7 1/2 years and \$130,000 in fines.

In addition to the 93 convictions obtained during the fiscal year, 30 convictions were affirmed by appellate courts in 12 cases. A number of the opinions affirming these convictions are extremely significant to the Commission's enforcement program. Early in the fiscal year the Court of Appeals for the Second Circuit, in *United Skates v. Ross*<sup>5</sup> affirmed the convictions of Howard Ross and Paul Gordon, salesmen for Kimball Securities, a "boiler-room" operation. The court rejected the contention of one of the salesmen who made misrepresentations to a customer, that he was warranted in relying on the information about the issuer given to him by his employer. It noted that even the few days during which the salesman had been employed prior to his misrepresentations were enough to "teach anyone ... exactly what was going on," and that the literature regarding the issuer prepared by his employer "was suspicious on its face to anyone with the slightest financial knowledge."

Shortly after the affirmance in *United States v. Ross*, the Court of Appeals for the Ninth Circuit, in *Farrell v. United States*, affirmed the convictions of David and Oliver Farrell for violations of the securities fraud, mail fraud and conspiracy statutes in connection with the sale of discounted trust deeds and mortgages issued by Los Angeles Trust Deed & Mortgage Exchange. The affirmance culminated one of the Commission's most intensive investigations and prosecutions involving fraudulent mortgage and trust deed promotions. Among other things, the court ruled that whether various instruments or investment programs were securities under the Securities Act was to be determined under Federal law and on the basis of what the defendants represented them to be.

During the fiscal year the final chapter in the prosecution involving the longest trial in the history of Federal criminal law was closed. The convictions of Virgil D. Dardi, Robert B. Gravis, Charles Rosenthal and Charles Berman were affirmed by the Court of Appeals for the Second Circuit, in *United States v. Dardi*. The Court rejected the contention, that the length of the trial (11 months) was prejudicial, stating that: "A multi-defendant stock fraud case, as involved as this one, usually necessitates the delving into many financial transactions. Those who participate in such transactions do not supply the government with a simple and clear picture. The picture, even as a jig-saw puzzle, only comes into

vision by the assembling of hundreds of curiously shaped parts, each piece seemingly having no identify until it is fitted into and made a part of the whole."

Finally, the Court of Appeals for the Second Circuit also affirmed the convictions of Martin Benjamin, an attorney, Bernard Howard, an accountant, and Milton Z. Mende in *United States v. Benjamin*. The court noted: "This appeal concerns another of those sickening financial frauds which so sadly memorialize the rapacity of the perpetrators and the gullibility, and perhaps also the cupidity, of the victims. It is unusual in that the vehicle, American Equities Corporation, owned nothing at all -- and, in a happier sense, in that the SEC was able to nip the fraud quite early in the bud." With respect to Benjamin and Howard, the court emphasized that "in our complex society the accountant's certificate and the lawyer's opinion can be instruments for inflicting pecuniary loss more potent than a chisel or the crow-bar ... Congress equally could not have intended that men holding themselves out as members of these ancient professions should be able to escape criminal liability on a plea of ignorance when they had shut their eyes to what was plainly to be seen or represented a knowledge they knew they did not possess."

## **OFFICE OF PROGRAM PLANNING**

The Office of Program Planning was established during the fiscal year. A primary responsibility of the Office during its first year was to assist and advise the Commission in the implementation of the recommendations of the Special Study of Securities Markets. To this end the Office participated, in coordination with other Commission Offices and Divisions, in the legislative effort which culminated in the Securities Acts Amendments of 1964, in the drafting and evaluation of various rules which were proposed and/or adopted by the Commission, and in counseling with the self-regulating agencies on rules adopted by the latter. In the latter area, the Office devoted particular attention to the standards applicable to selling practices, market literature and written investment advice. It began an analysis of the over-the-counter market for listed securities with a view toward measuring the impact and effect of trading in listed securities off the national securities exchanges. Toward the end of the fiscal year the Office began preparations for studies to examine problems involved in securities distributions, and analysis of broker-dealer economics.

## **COMPLAINTS AND INVESTIGATIONS**

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

The nine regional offices of the Commission, with the assistance of their respective branch offices, are chiefly responsible for the conduct of investigations. In addition, the

Office of Enforcement of the Division of Trading and Markets of the Commission's headquarters office conducts investigations dealing with matters of particular interest or urgency, either independently or assisting the regional offices. The Office of Enforcement also exercises general supervision over and coordination of the investigative activities of the regional offices. Its staff examines and analyzes the investigative findings and recommendations of the regional offices and recommends appropriate action to the Commission.

There are available to the Commission several sources of information concerning possible violations of the provisions of the Federal securities laws. The primary source of information is complaints by members of the general public concerning the activities of certain persons in securities transactions. The Division of Trading and Markets and the regional offices give careful consideration to this information and, if it appears that violations of the Federal securities laws may have occurred, an investigation is commenced. Other sources of information which are of assistance to the Commission in carrying out its enforcement responsibilities are the national securities exchanges, brokerage firms, state and Canadian securities authorities, better business bureaus, the National Association of Securities Dealers, Inc., and various law enforcement agencies.

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

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

During the past year 142 formal orders were issued in connection with investigations handled through the Division of Trading and Markets. In addition, there were 14 formal orders issued upon the recommendation of the Division of Corporate Regulation and 12 upon the recommendation of the Division of Corporation Finance. The latter Division conducts certain investigative work in connection with the processing of filings under the Securities Act of 1933 and the Securities Exchange Act of 1934.

When an investigation has been completed and enforcement action appears appropriate, the Commission may proceed in one of several ways. It may refer the case to the Department of Justice for criminal prosecution. The Commission may also, when appropriate, institute civil proceedings for injunctive relief to halt further violations of law. In that event a complaint is filed in the appropriate U.S. district court and the case is presented by a member of the Commission's staff. Finally, if the case is one where the Commission has the power to institute administrative proceedings, that avenue may be chosen as the most appropriate under the circumstances.

The following table reflects in summarized form the investigative activities of the Commission during fiscal 1964:

[table omitted]

## **ENFORCEMENT PROBLEMS WITH RESPECT TO FOREIGN SECURITIES**

The unlawful offer and sale of Canadian securities in the United States remained at a very low level in fiscal 1964. For the most part, the cooperation of Canadian officials and segments of the Canadian securities industry with the Commission has been very good.

The recent trend toward an increase in fraudulent promotions from the Bahamas and Panama continued during fiscal 1964. In dealing with these problems, the Commission is experiencing considerable success with the new and simplified procedures for obtaining foreign postal fraud orders. The success of this program is due in large measure to the continuing cooperation of the Post Office Department.

The Commission is still hampered by jurisdictional problems, including the status of the Supplementary Extradition Convention with Canada.

The Commission continues to maintain its Canadian Restricted List, which consists of Canadian companies whose securities the Commission has reason to believe are being, or recently have been, distributed in the United States in violation of the registration requirements of the Securities Act of 1933. The list and supplements thereto are issued to and published by the press, and copies are mailed to all registered broker-dealers and are available to the public. As a practical matter, most United States broker-dealers refuse to execute transactions in such securities.

Five supplements and a revised cumulative list were issued in fiscal 1964. Reflecting the more effective enforcement activities here and in Canada, it was necessary to add only two names to the list during the year, compared with seven names added in fiscal 1963, 9 in fiscal 1962, 47 in fiscal 1961, and 82 in fiscal 1960. A total of 117 names were deleted during the year, following compliance with established procedures. The number of names on the list as of June 30, 1964, was 139, the smallest in several years.

The current list, as of September 30, 1964, follows:

#### CANADIAN RESTRICTED LIST

Abbican Mines, Ltd.

Adonis Mines, Ltd.

Alaska Highway Beryllium Venture

Alouette Mines, Ltd.

Anuwon Uranium Mines, Ltd.

Ambassador Mining Developments, Ltd.

Americanadian Mining & Exploration Co., Ltd.

Anthony Gas and Oil Explorations, Ltd.

Associated Livestock Growers of Ontario

.Atlantis Industrial Development Co., Ltd.

Autofab, Ltd.

Ava Gold Mining Co., Ltd.

Barite Gold Mines, Ltd.

Bayonne Mine, Ltd.

Bengal Development Corp., Ltd.

Black Crow Mines, Ltd.

Blue Spring Explorations

Bonwitha Mining Co., Ltd.

Burbank Minerals, Ltd.

Cable Mines and Oils, Ltd.

Caesar Minerals, Ltd.

Cameron Copper Mines, Ltd.

Canol Metal Mines, Ltd.

Canford Explorations, Ltd.

Cartier Quebec Explorations, Ltd.

Central and Eastern Canada Mines (1958), Ltd.

Centurion Mines, Ltd.

Consolidated Exploration & Mining Co., Ltd.

Consolidated Woodgreen Mines, Ltd.

Crusade Petroleum Corp., Ltd.

Dayjon Explorers, Ltd.

Devonshire Mining Co., Ltd.

Devonshire Mining Syndicate Dolmac Mines, Ltd.

Dominion Fluoridators, Ltd.

Dominion Granite and Marble, Ltd.

Elk Lake Mines, Ltd.

Explorers Alliance, Ltd.

Fairmont Prospecting Syndicate

Federal Chibougamau Mines, Ltd.  
Foreign Exploration Corp., Ltd.  
Fort Hope Grubstake, The  
Franksin Mines, Ltd.  
Gasjet Corp., Ltd.  
Genex Mines, Ltd.  
Georay Prospecting Syndicate  
Golden Algoma Mines, Ltd.  
Guardian Explorations, Ltd.  
Haitian Copper Mining Corp., Ltd.  
Hallmark Explorations, Ltd.  
Ibsen Cobalt-Silver Mines, Ltd.  
International Claim Brokers, Ltd.  
Irando Oil and Exploration, Ltd.  
Jack Haynes Syndicate  
Jaylac Mines, Ltd.  
Kateri Mining Co., Ltd.  
Keele Industrial Developments, Ltd.  
Kelkirk Mines, Ltd.  
Kelly-Desmond Mining Corp., Ltd.  
Kenilworth Mines, Ltd.  
Kennament Development Corp., Ltd.

Key West Exploration Co., Ltd.  
Kimberly Copper Mines, Ltd.  
Kipwater Mines, Ltd.  
Kordol Explorations, Ltd.  
Korich Mining Co., Ltd.  
Kukatush Mining Corp.  
Kuskokwim Grubstake  
Ladysmith Explorations, Ltd.  
Leader Mining Corp., Ltd.  
Mack Lake Mining Corp., Ltd.  
Maple Leaf Investing Corp., Ltd.  
March Minerals, Ltd.  
Marian Lake Mines, Ltd.  
Marpoint Gas & Oil Corp., Ltd.  
Megantic Mining Corp.  
Merrican International Mines, Ltd.  
Midas Mining Co., Ltd.  
Mid-National Developments, Ltd.  
Milmar-Island Mines, Ltd.  
Milldale Minerals, Ltd.  
Mina-Nova Mines, Ltd.  
Missile Metals and Mining Corp., Ltd.

Monarch Asbestos Co., Ltd.  
Montclair Mining Corp., Ltd.  
Nationwide Minerals, Ltd.  
Natto Mining Co., Ltd.  
New Campbell Island Mines, Ltd.  
New Hamil Silver-Lead Mines, Ltd.  
New Mallen Red Lake Mines, Ltd.  
New Surpass Petrochemicals, Ltd.  
Norbank Explorations, Ltd.  
North Lake Mines, Ltd.  
North Tech Explorations, Ltd.  
Northport Mineral Explorers, Ltd.  
Nu-Gord Mines, Ltd.  
Nu-World Uranium Mines, Ltd.  
Olympus Mines, Ltd.  
Outlook Explorations, Ltd.  
Peace River Petroleums, Ltd.  
Prestige Lake Mines, Ltd.  
Rambler Exploration Co., Ltd.  
Regal Mining & Development, Ltd.  
Revere Mining Corp., Ltd.  
Roberval Mining Corp.

Rockroft Explorations, Ltd.

Rothsay Mines, Ltd.

St. Anthony Mines, Ltd.

St. Lawrence Industrial Development Corp.

Ste. Sophie Development Corp.

St. Stephen Nickel Mines, Ltd.

Sastex Oil and Gas, Ltd.

Savoy Copper Mines, Ltd.

Sico Mining Corp., Ltd.

Sinclair Prospecting Syndicate

Strathcona Mines, Ltd.

Sturgeon Basin Mines, Ltd.

Success Mines, Ltd.

Sudbay Beryllium Mines, Ltd.

Tabor Lake Gold Mines, Ltd.

Taiga Mines, Ltd.

Territory Mining Co., Ltd.

Trans-Leduc Oils, Ltd.

Trans Nation Minerals, Ltd.

Trans-Oceanic Hotels Corp., Ltd.

Trenton Petroleum & Minerals Corp., Ltd.

Triform Explorations, Ltd.

Triform Explorations (B.C.), Ltd.

Tumac Mining & Development Co., Ltd.

Turbenn Minerals, Ltd.

Turzone Explorations, Ltd.

Tyndall Explorations, Ltd.

Upper Ungava Mining Corp., Ltd.

Ver-Million Gold Placer Mining, Ltd.

Vimy Explorations, Ltd.

Western Allenbee Oil and Gas Co., Ltd.

Windy Hill Mining Corp.

Wingdam & Lightning Creek Mining Co., Ltd.

Yukon Prospectors' Syndicate

As a part of its enforcement program, the Commission maintains a Section of Securities Violations whose purpose is to aid the detection and prevention of fraud in securities transactions. The Section maintains files which provide a clearinghouse for other enforcement agencies for information concerning persons who have been charged with or found in violation of various Federal and state securities statutes. The information contained in these files is kept current through the cooperation of various governmental and nongovernmental agencies, including the U.S. Post Office Department, The Federal Bureau of Investigation, parole and probation officials, state securities authorities, Federal and state prosecuting attorneys, the National Association of Securities Dealers, Inc. (NASD), better business bureaus and chambers of commerce. At the end of the fiscal year the files contained information concerning 71,740 persons or firms against whom Federal or state action had been taken in connection with securities violations. During the year items of information concerning 8,599 persons or firms were added, including information as to 3,062 persons or firms not previously identified in these records. A total of 9,538 names was deleted, since the information concerning them was believed to be obsolete.

The Section issues and distributes to officials of cooperating law enforcement and other agencies in the United States and Canada a quarterly securities violations bulletin

containing information received during the period concerning alleged and actual violators and showing new charges and developments in pending cases. The bulletin includes a "wanted" section listing the names of persons wanted on securities violations charges, and references to bulletins containing descriptive information regarding them. It also includes a section reporting NASD disciplinary actions which resulted in the expulsion or suspension of an association member, or in the revocation or suspension of the registration of a representative of a member. This section of the bulletin identifies the disciplined member or representative and briefly describes the NASD's findings.

Extensive use is made of the information available in the files of the Section of Securities Violations by regulatory and law enforcement officials. Each year numerous requests are received for special reports on individuals, in addition to the information supplied by the quarterly bulletin. During the fiscal year the Commission received and disposed of 3,174 "securities violations" letters or reports and dispatched 733 communications to cooperating agencies.

#### **APPLICATIONS FOR NONDISCLOSURE OF CERTAIN INFORMATION**

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

The number of applications pending and the action taken on them during the year are set forth in the following table:

[table omitted]

#### **ACTIVITIES OF THE COMMISSION IN ACCOUNTING AND AUDITING**

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

Pursuant to the broad rulemaking power thus conferred with respect to the preparation and presentation of financial statements, the Commission has prescribed uniform systems of accounts for companies subject to the Holding Company Act; has adopted rules under the Securities Exchange Act governing accounting for and auditing of securities brokers and dealers; and has promulgated rules contained in a single comprehensive regulation, identified as Regulation S-X, which governs the form and content of financial statements filed in compliance with the several Acts. This regulation is supplemented by the Commission's Accounting Series Releases, of which 99 have so far been issued. These releases were inaugurated in 1937 and were designed as a program for making public from time to time opinions on accounting principles for the purpose of contributing to the development of uniform standards and practice in major accounting questions. The rules and regulations thus established, except for the uniform systems of accounts which are regulatory reports, prescribe accounting principles to be followed only in certain limited areas. In the large area of financial reporting not covered by such rules, the Commission's principal means of protecting investors from inadequate financial reporting, fraudulent practices and overreaching by management is by requiring a certificate of an independent public accountant, based on an audit performed in accordance with generally accepted auditing standards, which expresses an opinion as to whether the financial statements are presented fairly in conformity with accounting principles and practices which are recognized as sound and which have attained general acceptance.

The Securities Act provides that the financial statements required to be made available to the public through filing with the Commission shall be certified by "an independent public or certified accountant." The other three statutes permit the Commission to require that such statements be accompanied by a certificate of an independent public accountant, and the Commission's rules require, with minor ' exceptions, that they be so certified. The value of certification by qualified accountants has been conceded for many years, but the requirement as to independence, long recognized and adhered to by some individual

accountants, was for the first time authoritatively and explicitly introduced into law in 1933. Under the Commission's rules, an accountant who is qualified to practice in his own state is qualified to practice before the Commission unless he has entered into disqualifying relationships with a particular client, such as becoming a promoter, underwriter, voting trustee, director, officer, employee, or stockholder; has demonstrated incompetence or subservience to management; or has engaged in unethical or improper professional conduct.

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

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

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

Financial Executives Institute appoint committees which maintain liaison with the Commission's staff.

The Commission on its part has authorized its Chief Accountant to continue to serve as a member of an advisory committee to the Accounting Principle Board of the American Institute of Certified Public Accountants. This committee has been serving as adviser to the Institute's Director of Research who has been engaged in making an inventory of accounting principles and practices recognized by the accounting profession and currently in use. The work on this inventory is nearing completion and will be published soon by the Institute. The Chief Accountant has also served on a somewhat similar committee of the American Accounting Association.

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

Prefiling and other conferences with officials of corporations, practicing accountants and others are also an important part of the work of the staff. Resolution of questions and problems in this manner saves registrants and their representatives both time and expense. The 1964 amendments to the securities acts will bring into contact with the Commission many heretofore "unregulated" companies. Undoubtedly, in many cases, the accountant will be a primary bridge between the issuer and the Commission. The accountant will be called on to advise on the establishment of systems and controls which will promote the most effective and comprehensible form of compliance. A little foresight can avoid many unnecessary, and possibly embarrassing, problems. For example, when it is contemplated that a company will have to register in the future -- as when the shareholder limit under the 1964 amendments drops to 500 after about 2 years - - the appropriate internal controls should be established now to avoid potential problems which might preclude the issuance of an unqualified certificate.

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

divisions and by the Chief Accountant, they are referred to the Commission for consideration and decision.

Difficulties often arise in connection with initial filings because accountants and other advisers who serve the registrant have not had any prior experience with the Commission. In some cases these persons have not familiarized themselves with the rules and regulations of the Commission -- particularly the instructions as to financial statements required by the forms, the rules relating to independence of the certifying accountant, and those relating to the form and content of financial statements as set forth in Regulation S-X. In an effort to improve this situation several members of the accounting staff of the Commission participated in a course on filings with the Commission, at the invitation of the sponsor, the American Institute of Certified Public Accountants. This course, first offered in 1963, has been given in Chicago, Los Angeles, Milwaukee, New York, San Francisco, Washington, D.C., and elsewhere. In addition the Chief Accountant and other members of the staff have addressed accounting groups in many cities on the financial reporting requirements of the securities acts. This work is continuing and it is believed should facilitate the adjustment of companies becoming subject to those acts for the first time as a result of the 1964 amendments of the Securities Exchange Act of 1934.

During the year the Office of the Chief Accountant devoted considerable time to the various aspects of the 1964 amendments, and in response to a specific request of the Subcommittee on Commerce and Finance of the Committee on Interstate and Foreign Commerce, House of Representatives, prepared a memorandum on H.R. 6789 and H.R. 6793 which was included in the record on those bills. This memorandum set forth what the Commission understands to be some of the areas of accounting where alternative practices could produce materially different results under generally accepted accounting principles and included a statement as to the Commission's policy with respect to financial reporting.

The staff of the Chief Accountant's Office and the staff of the Office of Program Planning had several conferences during fiscal 1964 with representatives of the New York Stock Exchange for the purpose of securing information necessary for a better understanding of the Stock Exchange's commission rate structure and level. As recommended by the Special Study, the Income and Expense Report developed by the Exchange was reviewed to determine whether that report could be revised to be more useful as a basis for studies by this Commission and the Exchange.

Representatives from the Chief Accountant's Office, the New York Stock Exchange, and its consultants Price Waterhouse & Co., and the two odd-lot member firms conferred and made field investigations for the purpose of determining how the recommendation of the Special Study to the effect that "The New York Stock Exchange should recognize and meet its responsibility to regulate odd-lot differentials" should be implemented. These persons studied the operating methods and financial data of odd-lot dealers for the

purpose of developing a financial report which will reflect the income and expenses of the odd-lot functions of brokers and dealers in this area of the securities market.

Conferences were held between members of the Commission's staff from the Division of Trading and Markets, certain regional offices, and the Office of the Chief Accountant and representatives of the New York and Midwest Stock Exchanges, and representatives of the American Institute of Certified Public Accountants, to consider a proposed revision of Form X-17A-5, the annual report of financial condition required to be filed by certain brokers and dealers pursuant to Section 17 of the Securities Exchange Act of 1934. This form is being revised to meet changing conditions and practices in the securities industry and expanded and clarified for its use by small brokers and dealers not fully familiar with stock exchange practices.

Cooperation between the Office of the Chief Accountant and the Division of Corporate Regulation resulted in a proposed new rule and a proposed revision of annual report Form N-30A-1 under the Investment Company Act of 1940. The proposed new rule, Rule 2a-4, defines procedures to be followed in the periodic calculation of the net asset value of any redeemable security issued by a registered investment company for the purposes of distribution, redemption, and repurchase of such redeemable security. The proposed revision of annual report Form N-30A-1 which is filed with the Commission by registered management investment companies will require an accountant, in addition to certifying the financial statements in such reports, to assume varying degrees of responsibility as to the fair presentation of information presented in many other items, e.g., asset coverage of senior securities, portfolio turnover rates, and with respect to items in the minutes relating to financial matters.

## **INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT**

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

During the Bank's last fiscal year ending June 30, 1964, the Bank made 37 loans totaling \$809.9 million, compared with a total of \$448.7 million last year. The loans were made in Algeria, Chile (two loans), China, Colombia (two loans), Costa Rica, Denmark, Ecuador, El Salvador, Ethiopia, Finland, Iran, Japan (two loans), Liberia, Malaysia (two loans), Malta, Mauritius, Mexico, New Zealand (two loans), Nigeria, Norway, Pakistan (three loans), Peru (two loans), Portugal (two loans), Spain, Thailand, Tunisia, Venezuela, and Yugoslavia. This brought the total number of loans to 386 in 73 countries and territories and raised the gross total of commitments to \$7,931.3 million. By June 30, as a result of cancellations, exchange adjustments, repayments and sales of loans, the portion of loans signed still retained by the Bank had been reduced to \$5,191.9 million.

During the year the Bank sold or agreed to sell \$173.3 million principal amounts of loans, compared with sales of \$273.3 million last year. On June 30, the total of such sales was \$1,778.6 million, of which all except \$69 million had been made without the Bank's guarantee.

On June 30, the outstanding funded debt of the Bank was \$2,491.8 million, reflecting a net decrease of \$27.4 million in the past year. During the year, the funded debt was increased by \$104.5 million through the private placement of a \$100 million United States dollar bond issue and the delivery of \$4.5 million of bonds which had been subject to delayed delivery arrangements. The debt was decreased by \$131.9 million as a result of the maturing of the equivalent of \$107.8 million of bonds and of sinking fund and purchase fund transactions amounting to \$24.1 million.

During the fiscal year the following 17 countries became members of the Bank: Algeria, Burundi, Cameroon, Central African Republic, Chad, Congo (Brazzaville), Congo (Leopoldville), Dahomey, Gabon, Guinea, Kenya, Malagasy Republic, Mali, Mauritania, Rwanda, Trinidad and Tobago, and Uganda. Subscribed capital amounted to \$21,186 million on June 30, 1964.

## **INTER-AMERICAN DEVELOPMENT BANK**

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

During the year ended June 30, 1964, the Bank made 22 loans totaling the equivalent of \$119,977,000 from its ordinary capital resources, bringing the gross total of loan commitments outstanding at June 30, to 89, aggregating \$413,509,123. During the year, the Bank sold or agreed to sell \$6,273,524 in participations in the aforesaid loans, all of such participations being without the guarantee of the Bank. The loans from the Bank's ordinary capital resources were made in Argentina, Brazil, Chile, Colombia, Dominican Republic, Ecuador, Guatemala, Mexico, Peru, and Uruguay.

During the year the Bank also made six loans from its Fund for Special Operations totaling the equivalent of \$7,610,000, bringing the gross total of loan commitments outstanding at June 30, to 39, aggregating \$126,521,687. Participations in five loans in the aggregate amount of \$1,645,058 were sold during the year without the guarantee of the Bank. The Bank made 17 loans during the year from the Social Progress Trust Fund, which it administers under an Agreement with the United States, aggregating \$38,435,000, bringing the gross total of loan commitments outstanding at June 30, to 81, aggregating \$386,347,000.

During the year the Bank made its second sale of its primary obligations in the United States with a public issue of dollar bonds in the amount of \$50 million.

The outstanding funded debt of the Bank on June 30, 1964, was the equivalent of \$149,193,548, composed of \$125 million resulting from two sales of dollar bonds and Italian lire equivalent to \$24,193,548 resulting from the sale of bonds in Italy in April 1962.

The subscribed ordinary capital of the Bank on June 30, 1964, was the equivalent of \$813,160,000, of which \$431,580,000 represented callable capital.

## **STATISTICS AND SPECIAL STUDIES**

During the past fiscal year the Office of Statistical Studies (formerly Branch of Economic Research) continued its regular work in connection with the statistical activities of the Commission and the overall Government statistical program under the direction of the Office of Statistical Standards, Bureau of the Budget.

The statistical series described below are published in the Commission's Statistical Bulletin and in addition, except for data on registered issues, and on corporate pension funds, current figures and analyses of the data are published in quarterly press releases.

### **Issues registered under the Securities Act of 1933**

Monthly statistics are compiled on the number and volume of registered securities, classified by industry of issuer, type of security, and use of proceeds. Summary statistics

for the years 1935-64 are given in Appendix Table 1 and detailed statistics for the fiscal year 1964 appear in Appendix Table 2.

### **New Securities Offerings**

This is a monthly and quarterly series covering all new corporate and noncorporate issues offered for cash sale in the United States. The series includes not only issues publicly offered but also issues privately placed, as well as other issues exempt from registration under the Securities Act such as intrastate offerings and railroad securities. The offerings series includes only securities actually offered for cash sale, and only issues offered for account of issuers. Annual statistics on new offerings for recent years as well as monthly figures from January 1963, through June 1964, are given in Appendix Tables 3,4, and 5.

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

### **Individuals' Saving**

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

### **Private Pension Funds**

An annual survey is made of private pension plans other than those administered by insurance companies, showing the flow of money into these funds, the types of assets in which the funds are invested and the principal items of income and expenditures. A new quarterly survey has been initiated in cooperation with certain large bank trustees and corporations to obtain quarterly figures on pension fund assets and stock transactions, and similar figures are being collected from property and casualty insurance companies. This information is to be combined with statistics on investments of other financial intermediaries, and it is planned that the data will be published in the current fiscal year.

### **Financial Position of Corporations**

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

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

### **Plant and Equipment Expenditures**

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

### **Directory of Registered Companies**

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

### **Stock Market Data**

The Office of Statistical Studies regularly compiles statistics on the market value and volume of sales on registered and exempted securities exchanges, round-lot stock transactions on the New York exchanges for accounts of members and nonmembers, odd-lot stock transactions on the New York exchanges, special offerings and secondary distributions. Data on round-lot and odd-lot trading on the two New York exchanges are released weekly. The other statistical data mentioned above, as well as these weekly series, are published regularly in the Commission's Statistical Bulletin.

## **OPINIONS OF THE COMMISSION**

Administrative proceedings under the statutes administered by the Commission and under its Rules of Practice generally involve a hearing before a hearing examiner and culminate in the issuance of an opinion by the Commission. Under a modified procedure adopted during the fiscal year and applicable to proceedings initiated on or after August 1, 1964,

the Commission will adopt the hearing examiner's decision if Commission review is not sought or if the Commission does not deem it appropriate to review that decision.

In the preparation of its opinions, the Commission, or the individual Commissioner to whom a case may be assigned for the preparation of an opinion, is generally assisted by the Office of Opinions and Review (formerly Office of Opinion Writing). This Office is directly responsible to the Commission and is completely independent of the operating divisions, consistent with the principle of separation of functions embodied in the Administrative Procedure Act. Where the parties to a proceeding waive their right to such separation, the operating division of the Commission which participated in the proceeding may assist in the drafting of the Commission's decision.

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

## **DISSEMINATION OF INFORMATION**

As indicated elsewhere herein, a wealth of financial and other information is contained in the registration statements and reports filed with the Commission, which are public documents available for inspection by investors and other interested persons. Much of this information finds its way into securities manuals and other financial publications. Various activities of the Commission serve to augment the public dissemination of financial and other information filed with the Commission and that reflected in decisions issued by and other actions of the Commission.

To facilitate the public dissemination of this information, the Commission publishes a daily "News Digest" containing a resume of each proposal for the public offering of securities for which a registration statement is filed, as well as a summary of each order, decision or rule issued or other action taken by the Commission. Thus, during the year, the Digest included a report on each of the 1,039 registration statements filed with the Commission (not including investment company filings which added additional securities by way of amendments to previous filings); and it also included summaries of the 889 orders, decisions, rules and other actions of the Commission. It also summarized 300 releases announcing injunctive and other enforcement actions of the Commission. The Digest is made immediately available to the press; and it also is reprinted and distributed by the Government Printing Office, on a subscription basis, to some 2,565 investors, securities firms, practicing lawyers and others. The Commission also makes a more limited distribution of the full text of its decisions and other actions.

Through public discussions by individual members of the Commission and staff officers, including addresses before professional, business and other groups and participation in

panel discussions, the Commission also seeks to promote a better understanding of the provisions of the laws it administers and the rules promulgated thereunder, thus facilitating compliance therewith.

### **Information Available for Public Inspection**

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

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

Under the existing contract with a printing company for the reproduction of material in the Commission's public files in response to requests of members of the public, photocopies may be obtained at a reduced cost of 0.08 cent per page for pages not exceeding 8 1/2" by 14" in size. The detailed per-page prices are given in Release No. 34-7351 which may be obtained from the publications unit of the Commission. The charge for each certification of any document by the Commission is \$2.

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

Each year many thousands of requests for photocopies of and information from the public files of the Commission are received by the public reference room in Washington, D.C. During the year 5,132 persons examined material on file in the Washington, D.C. office and several thousand others examined files in the New York and Chicago regional offices. Over 18,268 searches were made for individuals requesting information and approximately 2,164 letters were written with respect to information required.

## **PUBLICATIONS**

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

### **Monthly:**

Statistical Bulletin.

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

### **Quarterly:**

Financial Report, U.S. Manufacturing Corporations (jointly with the Federal Trade Commission).

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

New Securities Offerings.

Volume and Composition of Individuals' Saving.

Working Capital of U.S. Corporations.

### **Annually:**

Annual Report of the Commission.

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

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

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

Corporate Pension Funds.

Directory of Companies Filing Annual Reports.0 Other Publications:

Decisions and Reports of the Commission.

Securities and Exchange Commission -- Its Functions and Activities.

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

Report of Special Study of Securities Markets.

## **ORGANIZATION**

The Commission's staff consists of attorneys, security analysts, accountants, engineers, investigators and administrative and clerical personnel.

During the fiscal year, certain organizational changes were effected pursuant to recommendations of the Special Study of Securities Markets.

In July 1963, a new Office of Program Planning was established to assist the Commission in reviewing and formulating policy and of coordinating activities in the implementation of the Special Study's recommendations. This work involves, in coordination with other Commission offices and divisions, changes in the rules, regulations and policies of the Commission and self-regulatory agencies; recommendations for legislation; proposals for modifications of industry practices; and procedures for gathering and analyzing economic data about the securities markets.

In October 1963, the Division of Trading and Exchanges was renamed the Division of Trading and Markets, and its functions were realigned to implement the recommendation contained in the Report of the Special Study that the Division be so organized and staffed that it might more adequately oversee the operation of the self-regulatory agencies, examine on a continuous basis changing market circumstances and regulatory needs and appraise the adequacies of existing regulatory measures. In addition, the Report recommended that the Division's research activities be expanded so that greater emphasis be given to the compilation, analysis and, where appropriate, publication of data concerning certain aspects and developments in the trading markets. As reconstituted, the Division consists of six units -- the Offices of Chief Counsel, Criminal Reference, Enforcement, Regulation, Special Proceedings, and Statistical Studies.

Another change effected during the year involved the transfer of the Section of Machine Tabulation from the Office of the Comptroller to the Office of Records and Service. This change was made in contemplation of the installation of a computer during fiscal year 1965, which is to be operated by the staff of that Section.

## **PERSONNEL AND FINANCIAL MANAGEMENT**

Highlights of the Commission's personnel program in fiscal 1964 included (1) increased activities designed to curb grade escalation, (2) the addition of an important fringe benefit in the form of accident insurance, (3) the conduct of OPERATION SCAN under the incentive awards program, (4) participation in the Federal government's program for hiring mentally retarded persons and (5) the continuation of after-hours training of employees.

In the 6 years from 1958 to 1963, the average grade in the Commission rose from 8.8 to 9.1. This is a 3.4 percent increase as compared with a 12.5 percent increase for all agencies. Similarly, the number of positions in grades GS-13 through GS-18 increased only 10 percent as compared with an increase of 59 percent for all agencies. Although no significant or unwarranted rise in the grades of its positions was found, the Commission instituted measures to control upgradings which could not be fully justified. As of June 30, 1964, the average grade was 9.2.

All employees were offered complete accident insurance coverage at group rates under the Securities Commission Accident Plan (SCAP) adopted in June 1964. This plan is offered as an employee service at no cost to the Commission. Employees pay the total cost of premiums and deal directly with the insurance company or its agent on a private transaction basis. The plan is particularly attractive to employees who perform considerable official travel.

OPERATION SCAN was launched in April 1964 in an all-out effort to spur all Commission employees to propose and devise new ways to improve job performance and to suggest ways to improve methods, reduce costs, increase productivity, and save man-hours. Members of the Commission sent a letter to each employee urging wholehearted participation in the program. Chairman John W. Macy, Jr., of the Civil Service Commission in a letter to the Chairman stated:

"My congratulations to you and your associates for this imaginative response to the President's call for an intensified effort aimed at encouraging employee ideas for cutting costs and increasing efficiency during this Tenth Anniversary year of the incentive awards program. We plan to bring this program to the attention of other agencies ..."

The Commission was one of the first Federal agencies to employ a qualified mentally retarded person under the special appointing authority approved by the Civil Service

Commission. The young man entered on duty as a messenger on February 17, 1964 and he has performed satisfactorily.

Formalized training in the work of the Commission continued to be emphasized by several of the divisions and offices. The Division of Trading and Markets conducted its Third Annual Seminar on Investigative Techniques and Trial Practice in the spring of 1964. Eight after-hour sessions were conducted. A highlight of the Seminar was a mock administrative hearing held in the court room of the United States Court of Military Appeals.

The Commission's General Counsel, Philip A. Loomis, Jr., received a Career Service Award from the National Civil Service League in April 1964. He is the third employee to be accorded this honor. Andrew Barr, Chief Accountant of the Commission, received the 1964 Alpha Kappa Psi Foundation Award. Frederick Moss, Chief, Office of Special Proceedings, Division of Trading and Markets, was a semi-finalist for one of 10 Arthur S. Flemming Awards presented annually to outstanding young men in the Federal Service.

During the period April 15, 1963 through June 30, 1964, 130 members of the staff received an additional within-grade salary increase in recognition of high quality performance. These awards are authorized by Section 702 of the Classification Act of 1949, as amended by the Salary Reform Act of 1962.

Cash awards totaling \$5,700 and certificates of merit were presented to 48 employees at the Commission's Eighth Annual Service and Merit Awards Ceremony, held in October 1963.

The following comparative table shows the personnel strength of the Commission as of June 30, 1963 and 1964:

[table omitted]

The table on page 161 shows the status of the Commission's budget estimates for the fiscal years 1960 to 1965, from the initial submission to the Bureau of the Budget to final enactment of the annual appropriation.

The Commission is required by law to collect fees for registration of securities issued, qualification of trust indentures, registration of exchanges, and sale of copies of documents filed with the Commission.<sup>46</sup>

The following table shows the Commission's appropriation, total fees collected, percentage of fees collected to total appropriation, and the net cost to the taxpayers of Commission operations for the fiscal years 1962, 1963, and 1964:

[table omitted]