

STATEMENT OF THE SECURITIES AND EXCHANGE COMMISSION
BEFORE THE SUBCOMMITTEE ON OVERSIGHT AND INVESTI-
GATIONS AND THE SUBCOMMITTEE ON CONSUMER PROTECTION
AND FINANCE, COMMITTEE ON INTERSTATE AND FOREIGN
COMMERCE OF THE HOUSE OF REPRESENTATIVES, AT JOINT
OVERSIGHT HEARINGS ON THE FUNCTIONING AND ADMINI-
STRATION OF THE SECURITIES ACTS AMENDMENTS OF 1975
(July 28, 1977)

These written comments of the Securities and Exchange Commission respond to the request addressed to the Commission in the letter dated July 13, 1977, to Commissioner John R. Evans from the Honorable John E. Moss, Chairman, Subcommittee on Oversight and Investigations, and the Honorable Bob Eckhardt, Chairman, Subcommittee on Consumer Protection and Finance, of the House Committee on Interstate and Foreign Commerce. At the Subcommittees' request, these comments report on the Commission's implementation of the provisions of the Securities Acts Amendments of 1975 (the "1975 Amendments") 1/ concerning the registration and regulation of municipal securities brokers and dealers, particularly Section 15B of the Securities Exchange Act of 1934 (the "Act"), 2/ and on the Commission's oversight of the Municipal Securities Rulemaking Board (the "MSRB").

Background. Before the 1975 Amendments were enacted, the Commission's regulatory authority under the Act did not generally extend to trading in municipal securities or to the qualifications and conduct of municipal securities professionals. The Commission's power in those areas was limited essentially to enforcement of the antifraud provisions in the federal securities laws when violations had already occurred. Fraud actions brought by the Commission before 1975 indicated that unwary investors were exposed to improper and illegal practices in the purchase and sale of municipal

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

2/ 15 U.S.C. 78o-4.

securities. 3/ Those cases revealed what the Senate Committee on Banking, Housing and Urban Affairs characterized as a "disturbing pattern of professional misconduct by a significant number of broker-dealers." 4/ The Commission's antifraud actions had some deterrent effect, but they did not regulate entry into the municipal securities business or provide prophylactic measures to reduce the opportunity for fraud and other abuses.

The Congress responded by including in the 1975 Amendments provisions for a new structure to regulate municipal securities professionals in a manner similar in some respects to the Commission's regulation of brokers and dealers in corporate securities. A new and unique regulatory framework was established, however, to accommodate the municipal securities industry, which is composed of (i) commercial banks already subject to supervision by federal and state bank agencies; (ii) diversified securities firms subject to regulation by the National Association of Securities Dealers, Inc. (the "NASD"), the national securities exchanges and the Commission; and (iii) firms dealing solely in municipal and other exempt securities and thus not previously subject to federal regulation.

Primary examination, inspection and enforcement authority over bank municipal securities dealers was granted to the federal bank agency responsible for regulating their banking activities and similar authority was granted to the NASD with respect to its members. To assure fair and uniform administration and enforcement, the Commission was granted broad disciplinary authority over all municipal securities brokers and dealers, including banks, and their associated persons.

3/ During the four years prior to 1975, the Commission brought seven injunctive actions, involving over 72 defendants, to halt fraudulent municipal securities trading activity.

4/ Securities Acts Amendments of 1975, Report of the Senate Comm. on Banking, Housing and Urban Affairs to Accompany S.249, S. Rep. No. 94-75, 94th Cong., 1st Sess. 43 (1975) (the "Senate Report").

Primary rulemaking authority for all municipal securities professionals was placed in the MSRB, an organization composed of members representing securities firms, bank dealers, investors and issuers of municipal securities. The MSRB was intended to use the collective expertise of its members to devise appropriate rules to raise the level of conduct in the municipal securities industry. 5/ Commission approval was required for most MSRB rules to become effective. The Commission was also granted authority to abrogate, add to, and delete from existing rules of the MSRB in any respect consistent with the objectives of the Act. 6/ In addition, the Commission's direct rulemaking authority was enhanced with respect to the control of fraudulent, manipulative, and deceptive acts and practices.

Appointment of the MSRB. Section 15B(b)(1) of the Act 7/ required the Commission to appoint the initial 15 members of the MSRB. On June 12, 1975, the Commission solicited public recommendations of candidates for appointment to that body. 8/ After reviewing over 500 letters recommending approximately 150 individuals and consulting with the federal bank regulatory agencies, the Commission announced its selection of the initial membership of the MSRB. 9/ Those initial members were appointed for two-year terms ending September 4, 1977.

Early this year, in response to the direction of Section 15B(b)(2)(B) of the Act, 10/ the MSRB filed with the Commission a proposed rule for the election

5/ Senate Report, at 46-7.

6 See Section 19(c) of the Act, 15 U.S.C. 78s(c).

7/ 15 U.S.C. 78o-4(b)(1).

8/ Securities Exchange Act Release No. 11469 (June 12, 1975).

9/ Securities Exchange Act Release No. 11635 (Sept. 5, 1975).

10/ 15 U.S.C. 78o-4(b)(2)(B).

of successor members. As subsequently amended by the MSRB and approved by the Commission, the rule provides for a nominating committee composed of the members of the MSRB whose terms are ending, and of persons representing municipal securities brokers and dealers, and members of the public. After the solicitation of public comment, the committee nominates three persons for each position to be filled and the MSRB selects one person from those nominated for each position. With respect to persons representing the public, 11/ the MSRB's selection is subject to Commission approval. 12/ For other than public members, however, the rule provides that an additional candidate (also conforming to announced criteria in terms of geographic representation and size and type of municipal securities broker or municipal securities dealer) can be nominated by 20 percent of the municipal securities brokers and municipal securities dealers who have paid the MSRB's initial fee. 13/ If such an additional candidate is nominated, an election will be held between that person and the MSRB's candidate. The Commission believes that the potential provided in the rule for direct participation by municipal securities professionals in the election process is particularly important in view of the statutory directive that the membership of the MSRB be representative of the various segments of the municipal securities industry.

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- 11/ Members of the MSRB are required by Section 15B(b)(2)(B) of the Act to be classified as representing either banks, broker-dealers, or the public.
- 12/ Commission approval is required by Section 15B(b)(2)(B) of the Act.
- 13/ MSRB rule A-12 requires that all municipal securities brokers and municipal securities dealers pay a one-time \$100 fee within 10 days of registration with the Commission.

Registration of Municipal Securities Brokers and Dealers. The 1975 Amendments also required the Commission to provide for the registration of municipal securities professionals, including bank municipal securities dealers, municipal securities dealers conducting an exclusively intrastate business, and brokers and dealers required to register as such under Section 15(a)(1) of the Act 14/ solely by virtue of their municipal securities activities. While registration of professionals other than banks was accomplished largely under the existing broker-dealer registration program, the registration of banks required the development of parallel rules and forms 15/ to accommodate the registration of "separately identifiable departments or divisions" of banks as that term is defined by the MSRB. 16/ The registration of municipal securities brokers and dealers, including banks, was accomplished without any apparently significant problems. As of July 22, 1977, a total of 1,496 brokers and dealers, including 330 bank municipal securities dealers, were registered. Of the

14/ 15 U.S.C. 78o(a)(1).

15/ The forms created included Form MSD and Form MSDW, 17 CFR 249.1100 and 249.1110. Rules 15Ba2-1, 15Ba2-2, and 15Ba2-3(T) under the Act, 17 CFR 240.15Ba2-1, 240.15Ba2-2, and 240.15Ba2-3(T), were adopted in the development of the registration process.

16/ Section 3(a)(30) of the Act, 15 U.S.C. 78c(a)(30), together with Section 15B(a), 15 U.S.C. 78o-4(a), effectively allows a bank municipal securities dealer the option of registering either the entire bank or a "separately identifiable department or division" thereof (as defined by the MSRB pursuant to Section 15B(b)(2)(H) of the Act, 15 U.S.C. 78o-4(b)(2)(H)). In addition, Rule 15b2B-1 under the Act, 17 CFR 240.15b2B-1, permitted the registration of separately identifiable departments or divisions of persons which were in existence on or before the date of enactment of the 1975 Amendments. The only entity registered under that provision is W. H. Morton & Co., a division of American Express Company.

330 banks currently registered, 251 have registered as a "separately identifiable department or division," while the remaining 79 have registered the entire bank.

The inclusion of banks in the municipal securities regulatory scheme has generated a number of requests for interpretation of the definitions in the Act of municipal securities broker and municipal securities dealer 17/ in order to assist banks in determining whether they must register. The Commission,

17/ Section 3(a)(31) of the Act, 15 U.S.C. 78c(a)(31), defines the term "municipal securities broker" to mean "a broker engaged in the business of effecting transactions in municipal securities for the account of others."

Section 3(a)(30) of the Act, 15 U.S.C. 78c(a)(30), provides that the term "municipal securities dealer" means "any person (including a separately identifiable department or division of a bank) engaged in the business of buying and selling municipal securities for his own account, through a broker or otherwise, but does not include --

(A) any person insofar as he buys or sells such securities for his own account, either individually or in some fiduciary capacity, but not as part of a regular business; or

(B) a bank, unless the bank is engaged in the business of buying and selling municipal securities for its own account other than in a fiduciary capacity, through a broker or otherwise: Provided, however, That if the bank is engaged in such business through a separately identifiable department or division (as defined by the Municipal Securities Rulemaking Board in accordance with Section 15B(b)(2)(H) of this title), the department or division and not the bank itself shall be deemed to be the municipal securities dealer."

in Securities Exchange Act Release No. 11742 (Oct. 15, 1975), applied the statutory definitions to a number of typical factual situations in order to provide early guidance in that regard. Since the issuance of that Release, the staff has provided additional guidance through "no-action" and interpretive letters.

Antifraud Rules. The 1975 Amendments expanded the Commission's authority to promulgate antifraud rules for municipal securities professionals. In the exercise of that expanded authority, the Commission has adopted a number of amendments to its rules under Sections 15(c)(1) and 15(c)(2) of the Act 18/ to provide for appropriate application of those rules to municipal securities brokers, municipal securities dealers, and transactions in municipal securities. 19/ In taking that action, the Commission put in place standards governing transactions in municipal securities in advance of the more gradual process of rule development being undertaken by the MSRB. 20/

18/ 15 U.S.C. 78o(c)(1) and 78o(c)(2).

19/ Securities Exchange Act Release No. 12468 (May 20, 1976).

20/ In addition to the adaptation of its existing rules and the development of rules implementing the registration requirements, the Commission has adopted Rule 17a-21 under the Act, 17 CFR 240.17a-21, to require the MSRB to file an annual report with the Commission. That report will enable the Commission to obtain the additional information it requires in order to include in its own comprehensive annual report to the Congress information with respect to the MSRB, as required by Sections 23(b)(2) and 23(b)(4)(B) of the Act, 15 U.S.C. 78w(b)(2) and 78w(b)(4)(B).

Staff Expertise. Since one result of the 1975 Amendments was to bring municipal securities professionals within a regulatory structure similar to that already in existence for brokers and dealers in corporate securities, the Commission's municipal securities program has been integrated to a considerable degree into existing regulatory programs. Consequently, the Commission has been able to direct the previously developed expertise of its staff to this new area. For example, examinations of municipal securities firms are conducted by the Commission's regular examiners, who have for years examined the books and records of integrated firms which do both a municipal and a corporate securities business. Similarly, the application of the Commission's financial responsibility rules to municipal securities brokers and municipal securities dealers other than banks has been analyzed by staff members who have had experience in adapting those rules to other types of securities businesses.

While relying to a large extent on the expertise of its staff with respect to the regulation of brokers and dealers generally, the Commission has also concentrated in a single office within the Division of Market Regulation the general administrative staff responsibilities for reviewing MSRB rules and maintaining liaison with the MSRB and with the bank regulatory agencies. The attorneys in that office devote the majority of their attention to municipal securities matters. The Commission also established within its Division of Enforcement an office with municipal securities responsibilities. Staff members having supervisory responsibility for these two offices participated in the development of the 1975 Amendments and have acquired further expertise concerning the municipal securities business since that time. In addition, the MSRB and its staff have assisted the Commission's staff by responding to questions concerning the operation of the municipal securities industry and by developing programs to familiarize Commission, NASD, and bank examiners with the MSRB rules as they are developed.

Commission Oversight of the MSRB. Although the complete package of MSRB rules envisioned in the 1975 Amendments is not yet in place, the MSRB now has addressed each mandatory subject area for rulemaking in Section 15B and each discretionary area, with the exception of arbitration. 21/ In order to afford the Board "ample opportunity to develop responsible rules for the industry," 22/ the Commission has generally avoided the use of its direct rulemaking powers in the areas for which the MSRB has concurrent rulemaking authority and has instead concentrated on evaluating the rules developed by the MSRB and filed with the Commission in accordance with Section 19(b) of the Act. In addition, the Commission's staff has frequently submitted comments on rule proposals which the MSRB has published in exposure draft form.

1. MSRB Rulemaking Procedures

The Commission's oversight of the MSRB can best be described in the context of MSRB rulemaking procedures. Following its internal development of a rule proposal, the MSRB authorizes the circulation of an "exposure draft," which provides an opportunity for public comment before the proposal is filed with the Commission under Section 19(b) of the Act. In response to the comments received on the exposure draft, the MSRB may circulate further exposure drafts or adopt and file the rule with the Commission.

21/ The MSRB's uniform practice rules have been filed with the Commission under Section 19(b) of the Act, 15 U.S.C. 78s(b). Its fair practice rules and rules concerning sales during the underwriting period have been circulated in exposure draft but have not yet been filed.

22/ Senate Report, at 48.

While the Commission itself takes formal action only in accordance with the procedures and standards set forth in Section 19 of the Act, the Commission has reviewed a number of staff letters commenting on MSRB exposure drafts. 23/ In that regard, the Commission recognizes the advantages of identifying relevant concerns early in the MSRB's rulemaking process. Particularly in view of the time deadlines for Commission action under Section 19(b), staff commentary on MSRB exposure drafts can, in the Commission's view, materially contribute to an open public discussion of MSRB exposure drafts at a more deliberate pace and in a more informal atmosphere than Section 19(b) affords. The staff letters represent the views of Commission's staff having expertise in the subject matter of the draft rules, but do not necessarily represent the final views of the Commission.

The interaction between the MSRB and the Commission's staff in connection with various drafts of an MSRB rule proposal concerning sales of municipal securities during the underwriting period illustrates that aspect of the rule development process. 24/ As

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- 23/ Written staff comment in response to MSRB exposure drafts has been conveyed with respect to MSRB rules concerning sales of municipal securities during the underwriting period, fair practices, and recordkeeping.
- 24/ The MSRB has issued several different draft G-11 rules which were intended to be responsive primarily to Section 15B(b)(2)(K) of the Act, 15 U.S.C. 78o-4(b)(2)(K), which requires the MSRB to establish the terms and conditions under which municipal securities dealers may sell, or to prohibit any municipal securities dealer from selling, any part of a new issue of municipal securities to a municipal securities investment portfolio during the underwriting period. The various G-11 rules have also been drafted in response to Section 15B(b)(2)(C), 15 U.S.C. 78o-4(b)(2)(C), which contains both a list of objectives which MSRB rules are directed to achieve and a list of results which they are not to produce.

published in exposure drafts dated September 8 and November 17, 1976, the MSRB's draft G-11 rules would have prohibited municipal securities dealers from joining underwriting syndicates in order to acquire securities for their own investment account or for related accounts. In addition, the rules would have established a "bona fide offering period" and provided that during that period both the syndicate itself and municipal securities dealers acquiring securities from the syndicate would be required to offer securities to customers only at a "bona fide offering price." After several discussions between the Commission's staff and the MSRB staff, the Director of the Division of Market Regulation sent a letter on February 1, 1977, to the Executive Director and General Counsel of the MSRB asking for an analysis of the problems which the draft rules were designed to address and expressing some staff concerns about certain of the draft rules' provisions. 25/

On March 16, 1977, the MSRB issued a new exposure draft of the G-11 rules resolving many of the problems which had concerned the Commission staff; among other things, the rules no longer provided for a "bona fide offering period" or a "bona fide offering price." On April 20, 1977, the Director of the Division of Market Regulation sent another letter to the MSRB staff, commenting on the new approach taken in the draft rules and also expressing some staff concerns with the new version. The exchange of views that has occurred between the staff of the Commission and the MSRB concerning the G-11 rules has both improved the Commission staff's understanding of the issues involved and helped to clarify the policies underlying the MSRB's rules as well as a number of technical aspects of the rules' proposed operation. The Commission understands that the G-11 rules have been approved by the MSRB and will be filed with the Commission in the near future.

25/ In particular, the letter expressed concern that the creation of a "bona fide offering period" and a "bona fide offering price" might be interpreted as establishing a scheme of retail price maintenance.

While the dialogue between the Commission and MSRB staffs often begins at the exposure draft stage, it may continue in appropriate cases after a proposed rule has been filed with the Commission, and may include meetings as well as written comment. 26/ The first instance on which the Commission's staff provided written comments on rules already filed with the Commission involved the MSRB's series of proposed rules establishing professional qualification standards. After a few meetings between the Commission's staff and the MSRB staff, the staff's concerns and the MSRB's responses to those concerns were presented and discussed in an exchange of letters between the Commission's staff and the MSRB. 27/ Shortly thereafter,

26/ The Commission's staff has provided written comments to the MSRB concerning its filings under Section 19(b) of the Act on professional qualifications, recordkeeping, uniform practices, and quotations.

27/ Pursuant to Section 23(a)(3) of the Act, 15 U.S.C. 78w(a)(3), the Commission is required to keep in a public file and make available for copying all written statements filed with the Commission and all written communications between the Commission and any person relating to a proposed rule change of a self-regulatory organization reviewed by the Commission pursuant to Section 19(b) of the Act. Although that Section does not require the Commission to include in the public file letters to and from its staff, letters preceding the filing of a proposed MSRB rule change are routinely sent to the public file once the proposed rule change has been filed and copies of staff letters sent or received thereafter are also generally sent to the public file.

the MSRB filed amendments which included changes based on the staff's comments. Accordingly, when the Commission formally considered the filing, its evaluation focused primarily on the two questions that had not yet been resolved -- the appropriateness of the MSRB's grandfather provision and of its apprenticeship requirements. The Commission found the MSRB explanation sufficient in both instances and approved, as consistent with the Act, the proposed rules, as amended.

2. Commission Consideration of Proposed MSRB Rules

The Commission's review of MSRB proposed rule changes filed under Section 19(b) of the Act includes a general consideration of any matters previously raised by the Commission's staff and extends not only to the legal sufficiency of proposed rule changes but also to the consistency of proposed rule changes with broad Congressional policies as embodied in the Act and as implemented by the Commission in its rules and regulations under the Act. Section 19(b) of the Act provides that, if the Commission does not find that a proposed rule change is consistent with applicable provisions of the Act and the rules and regulations thereunder, it shall institute proceedings to determine whether the proposed rule change should be disapproved. Consequently the institution of a proceeding to determine whether a proposed rule change should be disapproved must be made after analyzing both the proposed rule change and the statutory goals it is designed to address. If a proposed rule change is determined not to conform to those goals, the institution of a disapproval proceeding would appear appropriate.

3. Use of Disapproval Power

The Commission believes it appropriate not to substitute its judgment for that of the MSRB in selecting among alternative formulations of a rule. Instead, the Commission believes it should defer to the MSRB's expertise and judgment in situations where a number of alternative approaches might appropriately be adopted in formulating a rule.

The Commission has instituted a disapproval proceeding only once with respect to an MSRB filing. That proceeding 28/ concerned a series of proposed MSRB recordkeeping rules filed with the Commission. The Commission instituted the proceeding because it believed that the proposed MSRB rules should not apply to brokers and dealers already subject to Commission recordkeeping rules and because the Commission determined that the proposed MSRB rules were not technically sufficient under the standards of the Act. Notice of the disapproval proceeding was later withdrawn when the Commission and the MSRB were able to reach agreement on the application and form of the proposed rules. 29/

Although it was not necessary to conclude the disapproval proceeding with respect to the proposed MSRB recordkeeping rules, its institution reveals the Commission's willingness, in overseeing the operations of the MSRB, to insure that the MSRB's rulemaking authority is used to accomplish the purposes of the Act. 30/ The Commission and the MSRB have generally cooperated well, however, and the Commission believes that the interchange of views early in the MSRB rulemaking process limits the need for disapproval proceedings.

Coordination between the Commission and the Bank Regulatory Agencies. The effective functioning of the regulatory structure created by the 1975 Amendments depends on coordination and cooperation between the Commission and the various federal bank regulatory agencies. Although this multi-agency approach has not been in existence long enough to permit a comprehensive evaluation of its impact upon enforcement efforts, it appears to be workable and a number of steps have been taken to facilitate coordination among the agencies involved.

28/ Securities Exchange Act Release No. 12933
(Oct. 27, 1976).

29/ Securities Exchange Act Release No. 13109
(Dec. 23, 1976).

30/ Senate Report, at 50.

In accordance with Section 17(c) of the Act, 31/ the Commission has begun the development of procedures to notify the bank regulatory agencies of Commission examinations of banks and has delegated its authority in that regard to its Division of Market Regulation so that the notice which the Commission is required to give before examining a bank municipal securities dealer may be transmitted promptly. The Commission and the Office of the Comptroller of the Currency have conducted one joint examination of a bank municipal securities dealer. There has not been any apparent need for the Commission to examine any other bank municipal securities dealer; the Commission has been receiving from the bank regulatory agencies information relating to bank examinations performed by them and there have not been any reported violations of the federal securities laws by a bank municipal securities dealer. In addition, the Commission's staff and the staffs of the federal bank regulators have provided advice and assistance to one another on several projects, including the development of Form MSD-4, concerning the personal history of certain associated persons of bank municipal securities dealers. That information is required by the bank regulatory agencies in order to exercise their regulatory responsibilities.

Commission Use of New Enforcement Authority.
The 1975 Amendments imposed new substantive requirements on persons engaged in a municipal securities business and provided new procedural tools which the Commission could use in enforcing the expanded requirements, as well as those antifraud provisions which had previously been applicable. Among the substantive expansions were the inclusion of bank municipal securities dealers within the purview of the Act and the removal of municipal securities from the definition of exempted securities under certain sections of the Act. The latter change made applicable

31/ 15 U.S.C. 78q(c).

to persons dealing solely in municipal securities (i) the registration, financial responsibility, and recordkeeping requirements of the Act, (ii) certain of the Act's antifraud provisions (including hypothecation requirements), and (iii) the Commission's SECO rules applicable to non-NASD members registered with the Commission as brokers or dealers.

Before the 1975 Amendments were enacted, most of the antifraud provisions of the federal securities laws were applicable to any person engaged in a municipal securities transaction, but persons conducting solely a municipal securities business were not required to register with the Commission. Accordingly, the Commission could not invoke against such persons the full array of administrative sanctions which are available to enforce the antifraud provisions with respect to registered brokers and dealers. Instead, the Commission was required to rely more heavily on judicial remedies. The expansion of procedural tools which occurred as a result of the new registration requirements gives the Commission important flexibility in its enforcement efforts.

Since the enactment of the 1975 Amendments, the Commission has instituted thirteen administrative proceedings based on authority granted by those Amendments. Two proceedings arose out of actions instituted before the 1975 Amendments in which the Commission had been able to obtain injunctions based on violations of the Act's antifraud provisions; 32/ three proceedings were limited to violations of

32/ SEC v. Gulf Investment Bankers, Inc., Securities Exchange Act Release Nos. 13460 (Apr. 22, 1977), and 13140 (Jan. 7, 1977); SEC v. R. J. Allen and Associates, Inc., et al. Litigation Release Nos. 6653 (Dec. 27, 1974), and 6574 (Nov. 6, 1974).

antifraud provisions applicable before the enactment of the 1975 Amendments; 33/ and eight proceedings concerned violations of provisions made applicable by the 1975 Amendments to municipal securities transactions. 34/ The Commission has also instituted two injunctive proceedings based on the 1975 Amendments. 35/ At the present time, the Commission is conducting several formal investigations and informal inquiries which may result in enforcement action.

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- 33/ First Mississippi Securities, Inc., Securities Exchange Act Release No. 13779 (July 20, 1977); SEC v. Shelby Bond Service Corporation, et al., Litigation Release Nos. 7965 (June 9, 1977), and 7888 (Apr. 27, 1977); Glen Sivard Stevens and Bernard Terrance Tierney, Securities Exchange Act Release Nos. 13465 (Apr. 25, 1977), 13464 (Apr. 25, 1977), and 13244 (Feb. 4, 1977).
- 34/ Kurtz & Company, Inc., Securities Exchange Act Release No. 13520 (May 9, 1977); Baker, Welker and Company, Inc., Securities Exchange Act Release No. 13339 (Mar. 7, 1977); Allison-James, Incorporated, Securities Exchange Act Release No. 13257 (Feb. 14, 1977); All-States Tax Exempt Securities, Inc., Litigation Release No. 7551 (Sept. 8, 1976), Securities Exchange Act Release No. 12774 (Sept. 7, 1976), Litigation Release Nos. 7547 (Sept. 2, 1976), and 7460 (June 20, 1976); SMW Securities, Inc., Securities Exchange Act Release No. 12375 (Apr. 26, 1976); Hibbard & O'Connor Securities, Inc., Securities Exchange Act Release Nos. 12344 (Apr. 14, 1976), and 12343 (Apr. 14, 1976); A. H. Speer Co., Securities Exchange Act Release No. 13405 (Mar. 25, 1977); Delta Securities of Little Rock, Inc., Securities Exchange Act Release No. 13404 (Mar. 24, 1977).
- 35/ SEC v. Arthur T. Mudd and Bobby Hodges, Litigation Release No. 7939 (May 25, 1977); U.S. v. Andrew H. Speer, Litigation Release Nos. 7840 (Mar. 23, 1977), 7761 (Jan. 31, 1977), and 7752 (Jan. 25, 1977).

The Commission's municipal securities enforcement actions have addressed violations which range from the failure of a broker-dealer doing business only in municipal securities to comply with the Act's registration and reporting requirements to violations of the Act's antifraud provisions. The proceeding against Kurtz & Company, Inc., involved a broker-dealer which was engaged exclusively in a municipal securities business and was required to register with the Commission in December, 1975. In that action, the Commission alleged that the firm's application for registration failed to disclose that its capital consisted largely of loans of stock for which there were not valid subordination agreements permitting the loans to be treated as capital. The Commission further alleged that the firm had failed to make and keep current required books and records. In addition, the Commission alleged that the firm did not pay either its SECO fee or its SIPC assessments. The Commission issued an order imposing remedial sanctions on the basis of an offer of settlement submitted by the firm and its principal. The firm and its principal were each suspended for 60 days, and the principal was barred from acting in a supervisory capacity thereafter.

In an action against Hibbard & O'Connor Securities, Inc., the Commission alleged that a broker-dealer firm which had applied for registration, as well as its subsidiary (a registered broker-dealer) and three individuals affiliated with those firms, had violated Commission rules by (i) bidding for and purchasing securities for accounts in which they had beneficial interests before completing the distribution of such securities, (ii) permitting the hypothecation of customers' securities without appropriate customer authorization, (iii) failing to comply with financial responsibility and recordkeeping provisions, and (iv) failing to confirm customers' transactions properly. Pursuant to an offer of settlement, the Commission revoked the subsidiary broker-dealer's registration, barred two of the principals from being associated with a registered broker or dealer, and suspended the third principal for a period of 60 days.

Although these actions, which could not have been brought before the 1975 Amendments, constitute only a small segment of the Commission's overall municipal securities enforcement program, the power conferred by the 1975 Amendments to institute administrative proceedings against persons engaged solely in a municipal securities business is a critical enforcement tool. In addition, investor protection is enhanced by expanding the application of certain of the antifraud provisions under the Act to municipal securities transactions and by making municipal securities brokers and dealers subject to the reporting provisions under Section 17(a) of the Act. 36/

Effectiveness of Regulation. It is too soon to determine whether the system of municipal securities regulation being developed will prove effective over the long term in protecting investors, serving the interest of government issuers in a healthy and efficient market for securities and meeting the needs of the industry. In that regard, it will take some time to determine whether rules currently in place, rules adopted in the future, and compliance and enforcement programs based on those rules will address fully the problems which led to the enactment of municipal securities legislation in the 1975 Amendments.

Although the MSRB and the Commission have made substantial progress in completing the initial rulemaking required for implementation of the 1975 Amendments, further MSRB rulemaking will be needed to set appropriate standards for, among other things, practices related to the underwriting of municipal securities and municipal securities trading. In that regard, there may be substantial tension between the public interest goals MSRB rules are to promote, on the one hand, and the business interests of the industry on the other, particularly to the extent the establishment of mandatory standards requires

36/ 15 U.S.C. 78q(a).

substantial adjustments in current practices or imposes other burdens on industry participants. Resolution of any resulting conflict may be difficult in specific instances, but the Commission intends, in exercising its oversight responsibilities, to provide whatever impetus is needed for the achievement of an effective and appropriately comprehensive regulatory system.

Additional Legislation. At this time, it does not appear that there is a need to expand either the MSRB's jurisdiction or the Commission's authority with respect to municipal securities professionals. The Commission is concerned, however, with the absence of a uniform standard of required disclosure to which issuers and underwriters can refer and thus continues to urge the consideration of appropriate municipal securities disclosure legislation.

The Commission has authorized, and will soon file, two injunctive actions in which it will allege fraud in connection with the offer, purchase, and sale of Government National Mortgage Association mortgage backed securities. The Commission has also recently authorized three investigations into sales practices of government securities dealers. In that connection, the Commission is concerned that improper practices similar in impact to those uncovered in the municipal securities area before 1975 may be developing in the government securities markets. In fact, it appears that some persons who had earlier perpetrated frauds in the municipal securities markets may now be committing fraud in the government securities markets. It is too early, however, to provide definitive comments to the Subcommittees concerning a legislative response to those developing practices. The Commission intends to observe closely the operation of securities professionals in the government securities markets, to take enforcement action when appropriate, and, upon further experience, to consider carefully the need for additional legislation to require registration and regulation of brokers and dealers in government securities in order to curtail the incidence of fraud and other abuses.