1990 Annual Report

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

LETTER OF TRANSMITTAL

The Honorable Dan Quayle
President of the Senate
Washington, D.C. 20510

The Honorable Thomas S. Foley
Speaker of the House
Washington, D.C. 20515

Gentlemen:

I am honored to transmit the Securities and Exchange Commission's annual report for fiscal year 1990. The activities and accomplishments identified in the report once again reflect the Commission's long tradition of fiscal responsibility, hard work, and high achievement.

The 1990 fiscal year was highlighted by a number of remarkable achievements. In particular, the Commission:

• collected $232 million in fee revenue, which represents 139 percent of its annual funding level;

• obtained court orders requiring defendants to return illicit profits in a record amount of approximately $601.5 million, which consisted of disgorgement orders of $589 million and civil penalties of $12.5 million;

• supervised closely the liquidation of Drexel Burnham Lambert Group and its broker-dealer subsidiary, without any cost to the

American public or the federal budget outside of normal agency resources;

• reached a settlement with Michael R. Milken, who was ordered to pay $400 million in civil disgorgement and sentenced to ten years imprisonment, three years probation, and community service after pleading guilty to six felony counts, and who consented to pay an additional $200 million in criminal fines and penalties;

• helped to maintain market stability in the wake of the sharp market decline in October 1989;

• responded to the interruption of trading on the Pacific Stock Exchange (PSE) caused by the October 17, 1989 earthquake in northern California, by moving operations to the American Stock Exchange, Chicago Board Options Exchange, New York Stock Exchange, and Philadelphia Stock Exchange to allow for the trading of PSE options on their respective exchanges for two days; and

• entered into new agreements with five countries providing for exchange of investigative information, technical assistance, and other matters.

Law Enforcement

On October 15, 1990, the Securities Enforcement Remedies and Penny Stock Reform Act of 1990 was enacted to increase significantly the Commission's enforcement authority. Among other things, this legislation authorizes the Commission to seek penalties in both civil and administrative proceedings and to enter cease-and-desist orders.

A total of 304 enforcement actions were initiated by the Commission involving insider trading, financial disclosure, market manipulation, corporate control, securities offerings, broker-dealer and investment company violations, and other matters. Also, the Commission obtained court orders requiring defendants to return illicit profits in a record amount of approximately $601.5 million. This consisted of disgorgement orders of $579.8 million in non-insider trading cases and $9.2 million in insider trading cases, and civil penalties of approximately $12.5 million.

The Commission maintained its relentless pursuit of fraud, which included one of the most significant actions in the Commission's history. In fiscal year 1990, a settlement was reached with Michael R. Milken, a defendant in *SEC v. Drexel Burnham Lambert Inc.* The order entered against Milken enjoined him and required him to pay $400 million in civil disgorgement. The order further provided that Milken would cooperate in the Commission's continuing investigation and would be barred in administrative proceedings. The order was entered simultaneously with Milken's guilty plea to six felony counts. In connection with his guilty plea, Milken consented to pay an additional $200 million in criminal fines and penalties. In November 1990, Milken was sentenced on his guilty plea to ten years imprisonment, three years probation, and community service.

The Commission focused increased attention on the problem of fraudulent activity connected with financial institutions. Through contacts with the federal financial supervisory agencies and law enforcement authorities, the Commission has helped to sensitize financial institutions to the need for compliance with the federal securities laws.

Internationalization Affairs

The Commission entered into its two most comprehensive agreements on cooperation to date during fiscal year 1990. The Commission and the Ministry of Finance of the Netherlands, on behalf of their respective governments, signed an agreement on Mutual Administrative Assistance in the Exchange of Information in Securities Matters; and the Commission and its counterpart in France, the Commission des Operations de Bourse (COB), signed an Administrative Agreement. Both of these agreements provide for comprehensive assistance in securities matters. The Commission also signed an Understanding with the COB, which provides for consultation about matters of common interest to coordinate market oversight and resolve possible differences between regulatory systems. The Commission also signed Understandings with the Institut Monetairs Luxembourgeois of Luxembourg (IML) and the Comision Nacional de Valores (CNV) of Mexico. The Understanding with the IML provides for the exchange of information relating to trades cleared through a foreign clearance organization for the PORTAL trading system. The Understanding with the CNV is broad in scope, encompasses assistance in enforcement matters and the provision of technical assistance, and contemplates consultations about all matters relating to the operation of the securities markets in the United States and Mexico.

Other activities in the international area included the signing of a technical assistance agreement with the Republic of Hungary's State Securities Supervision and the Budapest Stock Exchange. The Commission also hosted the first joint meeting with the regulatory authorities for the securities markets of the United States, Japan and United Kingdom, which together represent approximately two-thirds of aggregate global equity market capitalization.

Regulation of the Securities Markets

The Commission pursued many initiatives to enhance the stability and integrity of the nation's securities markets. However, the most significant event was the work associated with passing the Market Reform Act of 1990, which requires that the Commission monitor securities markets, including (1) tracking the trading activities of large traders, to address the effects of extreme price movements and (2) assessing the risks to broker-dealers of the financial activities of their parent holding companies and other unregistered affiliates. Collectively, this Act and the Remedies Act represent the most significant changes to the securities laws in decades.

During fiscal year 1990, the Commission supervised closely the liquidation of Drexel Burnham Lambert Group and its broker-dealer subsidiary, which had more than 30,000 public customer accounts, holding approximately $5 billion in securities. The active role of the Commission in the liquidation of this $28 billion firm, working closely with the Federal Reserve and other agencies, was instrumental in preventing losses to investors and the Securities Investor Protection Corporation. Ultimately, the market was protected against instability without any cost to the American public or the federal budget outside of normal agency resources.

The staff conducted 22 inspections of the trading market facilities, market surveillance, and clearance programs of self-regulatory organizations. In the broker-dealer examination area, the staff completed 371 member oversight and 176 cause examinations. The number of cause examinations increased by 19 percent over 1989 to cover sales practices more extensively, particularly in light of abuses encountered in the penny stock market. As a result of an examination by the Commission, previously undetected massive capital and other violations were detected in Stotler Group, Inc., leading to the eventual closure of this firm, which had been one of the nation's top 10 futures brokerage firms, and two of its chief subsidiaries.

Investment Companies and Advisers

The Commission began a comprehensive review of the Investment Company Act to determine whether any changes in this statute would be appropriate in light of market developments over the past 50 years. This review is expected to lead to legislative recommendations affecting the nation's $1.2 trillion in investment company assets. The Division of Investment Management also conducted 2,249 examinations of investment companies and advisers, an increase of 14 percent from fiscal year 1989.

Full Disclosure

The Commission devoted significant efforts to issues of international importance, such as cross-border and global offerings. For example, the Commission adopted Regulation S to streamline the procedures for offering securities offshore, and Rule 144A to provide a safe harbor exemption from the registration provisions of the Securities Act of 1933 for resales of restricted securities to institutional investors. In addition, a task group in the Division of Corporation Finance completed reviews of the financial statements, management's discussion and analysis, and other related disclosures of 191 financial institutions. As a result of these reviews, 30 matters were referred to the Division of Enforcement for further inquiry or investigation.

Accounting and Auditing Matters

The Commission provided policy direction to the accounting profession to move toward using appropriate market-based measures in accounting for financial institutions. The Commission also

continued to devote significant resources to initiatives involving international accounting, auditing, and independence requirements.

Litigation and Legal Services

The Office of the General Counsel represented the Commission in 29 appeals before the Supreme Court and the United States Courts of Appeals. Of these, the Commission received adverse rulings in only seven matters. The staff also litigated 39 cases in the United States district courts, bankruptcy courts, and administrative tribunals.

Economic Research and Analysis

The economics staff developed or maintained seven monitoring programs to study the implementation of major rules, new trading facilities, and developments in the domestic and international securities markets. The staff also completed studies concerning the performance of circuit breaker mechanisms during the October 1987 market decline, and the effects of share turnover and margin credit on stock market volatility.

Management and Program Support

The Commission testified before Congress 19 times regarding issues such as the reform of securities and banking laws. The agency collected revenue of $232 million compared to a final appropriations level of $167 million—a $65 million net gain to the U.S. Treasury.

I look forward to working with the Congress in dealing with the complex issues facing the securities industry. The work associated with internationalization, maintaining market stability, restructuring of the United States financial system, and the ongoing battle against market manipulation and other forms of fraud against investors will

require both cooperation and continued hard work to achieve the most successful results.

Sincerely,

Richard C. Breeden
Chairman

ENFORCEMENT

The Commission's enforcement program is designed to preserve the integrity, fairness and efficiency of the securities markets, and thereby to protect investors and foster investor confidence in the markets. To meet these goals, the Commission has focused increased attention on particular problem areas, including penny stock fraud and violations involving financial institutions, while maintaining a strong presence in all other areas within its jurisdiction.

Key 1990 Results

The growth of the securities markets, both in size and sophistication, has resulted in the allocation of significant enforcement resources to the investigation and litigation of complex cases. The increasing globalization of the securities markets also places demands on Commission resources for prompt and effective action when suspect trading has a foreign component. Nonetheless, the total number of Commission cases in fiscal year 1990 remained high in comparison to other recent years.

In fiscal year 1990, the Commission obtained court orders requiring defendants to disgorge illicit profits in a record amount of approximately $589 million. Included are disgorgement orders in insider trading cases requiring the payment of approximately $9 million. Civil penalties under the Insider Trading Sanctions Act of 1984 (ITSA) were imposed by orders requiring the payment of approximately $12.5 million. In some instances, the payment of disgorgement and/or civil penalties pursuant to a court order was waived based upon the defendant's demonstrated inability to pay.

An estimated 151 criminal indictments or informations and 83 convictions were obtained by criminal authorities during fiscal year 1990 in Commission-related cases. The Commission granted access to its files to federal and state prosecutorial authorities in 134 cases.

The Commission has broad authority to investigate possible violations of the federal securities laws and to obtain appropriate remedies through litigation. Enforcement actions initiated by the Commission generally are preceded by an examination pursuant to the Commission's inspection powers or by an investigation. Under its inspection powers, the Commission is authorized to conduct examinations of regulated entities, including broker-dealers, municipal securities dealers, investment advisers, investment companies, transfer agents, and self-regulatory organizations (SROs). The Commission's investigations may be conducted either informally or formally. Informal investigations are conducted on a voluntary basis, with the Commission requesting persons with relevant information to cooperate by providing documents and testifying before Commission staff. The federal securities laws also empower the Commission to conduct formal investigations, in which the Commission has the authority to issue subpoenas that compel the production of books and records and the appearance of witnesses to testify. Both types of investigations are generally conducted on a confidential, nonpublic basis.

The Commission's primary enforcement mechanism for addressing violative conduct is the injunctive action filed in federal court. In these civil actions, the Commission is authorized to seek temporary restraining orders and preliminary injunctions as well as permanent injunctions against any person who is violating or about to violate any provision of the federal securities laws. A federal court injunction will prohibit future violations, and, once an injunction has been imposed,

conduct that violates the injunction will be punishable by either civil or criminal contempt, and violators will be subject to fines or imprisonment. In addition to seeking such orders, the Commission often seeks other equitable relief such as an accounting and disgorgement of illegal profits, rescission, or restitution. Also, when seeking temporary restraining orders, the Commission often requests a freeze order to prevent concealment of assets or dissipation of the proceeds of illegal conduct. The Commission is specifically authorized to seek civil penalties in connection with insider trading violations, pursuant to ITSA, as amended by the Insider Trading and Securities Fraud Enforcement Act of 1988.

Several types of administrative proceedings may be instituted by the Commission. The Commission may institute administrative proceedings against regulated entities, in which the sanctions that may be imposed include censures, limitations on activities, and suspension or revocation of registration. The Commission may impose similar sanctions on persons associated with such entities and persons affiliated with investment companies.

Administrative proceedings may be instituted against issuers as well. For example, Section 8(d) of the Securities Act of 1933 (Securities Act) enables the Commission to institute proceedings to suspend the effectiveness of a registration statement that contains false and misleading statements. Administrative proceedings pursuant to Section 15(c)(4) of the Securities Exchange Act of 1934 (Exchange Act) may be instituted against any person who fails to comply, and any person who is a cause of failure to comply, with reporting, beneficial ownership, proxy, and tender offer requirements. Respondents may be ordered to comply or effect compliance with the relevant provisions. Pursuant to Rule 2(e) of the Commission's Rules of Practice, administrative proceedings may be instituted against persons who appear or practice before the Commission, such as

accountants and attorneys; the sanctions that may be imposed in these proceedings include suspensions and bars.

The Commission also is authorized to refer matters to other federal, state or local authorities or SROs such as the New York Stock Exchange or the National Association of Securities Dealers (NASD). The staff often provides substantial assistance to criminal authorities, such as the Department of Justice, for the criminal prosecution of securities violations.

New Remedies

The Securities Enforcement Remedies and Penny Stock Reform Act of 1990, Pub. L. No. 101-429, which was signed into law on October 15, 1990, adds significantly to the Commission's enforcement authority. This legislation authorizes the Commission to seek, and the courts to impose, fines for any violations of the federal securities laws (with the exception of insider trading violations for which civil penalties continue to be available under ITSA). The Commission also is authorized to impose penalties in its administrative proceedings against regulated entities, such as brokers and dealers, and persons associated with regulated entities. The legislation authorizes the Commission to order an accounting and require disgorgement of illegal profits in such administrative proceedings.

In addition, the Commission for the first time is authorized to institute administrative proceedings in which it can issue cease-and-desist orders. Permanent cease-and-desist orders can be entered against any person violating the federal securities laws, and disgorgement of illegal profits may be required. The Commission is authorized to issue temporary cease-and-desist orders (if necessary, on an *ex parte* basis) against regulated entities and persons associated with regulated entities, if the Commission determines that the violation or

threatened violation is likely to result in significant dissipation or conversion of assets, significant harm to investors, or substantial harm to the public interest prior to completion of proceedings. The legislation also affirms the existing equitable authority of the federal courts to bar or suspend individuals from serving as corporate officers or directors. The penny stock provisions of the legislation, in addition to enhancing the Commission's power to provide an effective regulatory response to penny stock fraud, authorize the Commission to sanction individuals associated with a broker or dealer by barring or suspending them from participating *(e.g.,* as finders or consultants) in an offering of penny stock.

Enforcement Activities

The Commission maintained an aggressive enforcement presence in each area within its jurisdiction and strengthened its enforcement activities in critical areas. In December 1989, for example, the Commission announced the formation of a new enforcement unit devoted primarily to detecting, investigating, and prosecuting securities fraud in the banking and thrift industries. The Commission's Penny Stock Task Force also continued its highly successful campaign against fraud in the issuance, offer, and sale of penny stocks.

Unless otherwise noted in the discussion below, defendants or respondents who consented to settlement of actions did so without admitting or denying the factual allegations contained in the complaint or order instituting proceedings. See Table 22 for a listing of enforcement actions instituted in fiscal year 1990.

International Enforcement

A substantial number of investigations have international aspects, and the staff took depositions in and obtained information from a number of foreign countries. In conjunction with the Office of International Affairs, the staff prepared more than 160 requests to obtain such information from foreign authorities, pursuant to formal or informal agreements and understandings. Such requests for assistance generally require detailed submissions describing the investigation and setting forth the need for the requested information.

The staff worked on a substantial number of requests for assistance from agencies of foreign nations. Some of these requests involved extensive inquiries or investigations in order to collect the requested information. Pursuant to authority granted by the Insider Trading and Securities Fraud Enforcement Act of 1988, subpoena power was used in certain investigations conducted at the request of foreign securities authorities.

As part of its increasing emphasis on international coordination and cooperation, the staff has provided a number of training and education opportunities. For example, representatives from over 25 foreign securities agencies attended the 1990 Enforcement Training Program at the invitation of the Division of Enforcement.

With the increasing globalization of the securities markets, the Commission has continued to pursue swift and aggressive action to deal with suspect trading in the United States that originates from abroad or otherwise involves transactions by or through foreign accounts. Recent Commission enforcement actions demonstrate that the Commission's efforts to detect and remedy violations cannot be evaded through the use of overseas accounts.

The Commission brought three actions for emergency relief to freeze trading accounts with securities firms in the United States when

suspicious trading, originating abroad, occurred in those accounts shortly before the announcement of material corporate transactions. These cases involved considerable discovery and numerous proceedings to gather evidence both in the United States and abroad. In *SEC v. Finacor Anstalt*[1] the Commission filed an action against a Liechtenstein-based entity and other purchasers of call option contracts for the common stock of Combustion Engineering, Inc., a Swedish-Swiss company, shortly before the announcement of an offer for 80 percent of its outstanding common stock. The complaint alleged that on certain trading days, Finacor accounted for 70 percent of the trading in one series of options, and approximately 97 percent of the market in another series; and nearly 100 percent of the market in both series on another trading day. The Commission sought, and the court granted, a temporary restraining order and an order freezing assets. Thereafter, the court granted an application for preliminary injunctive relief. As of September 30, 1990, the case was still pending.

As a result of market surveillance by the Commission and the SROs, the Commission staff learned that a number of unknown individuals had traded heavily in the shares of Contel Corporation through Swiss and German financial institutions just prior to an acquisition offer for the company. Within one day of the public announcement of the acquisition offer, the Commission obtained a temporary restraining order and, ten days later, a preliminary injunction and a court order freezing more than $3 million in assets. Motions by defendants to dismiss the complaint were pending at the close of the fiscal year (*SEC v. Certain Purchasers of Common Stock and Call Option Contracts for the Common Stock of Contel Corporation*[2]*).* The Commission also obtained an emergency temporary restraining order and a freeze of assets in *SEC v. Fondation Hai.*[3] This case involved massive overseas trading in the stock of a United States company prior to the announcement of a proposed merger. Two of the foreign

defendants appealed preliminary injunctions and freeze orders entered against them. On appeal, the court upheld the freeze orders, with modifications, but set aside the preliminary injunction. One defendant consented to the entry of a permanent injunction and agreed to pay $1.4 million in disgorgement. As of September 30, 1990, the case was pending against the other defendants.

Violations Relating to Financial Institutions

The Commission recently has focused increased attention on the problem of fraud connected with financial institutions. Since its inception in December 1989, the special unit within the Division of Enforcement dedicated to investigating financial institutions and their officers, directors, and other persons associated with their business has been investigating financial fraud encompassing false financial statements and misleading disclosures in filings by publicly held institutions and holding companies, as well as the full range of other potential securities violations by persons associated with financial institutions, including insider trading.

Since January 1990, the Commission has brought four cases involving financial institutions and associated persons. In *SEC v. Jason M. Chapnick*[4] the Commission filed a complaint against former officers, directors, and/or affiliates of Commonwealth Savings and Loan Association of Florida. The complaint charged the individuals with insider trading, fraud in the offer, purchase and sale of securities, and false and misleading financial statements. At the close of the fiscal year, the proceeding was still pending.

The Commission also filed an action, *SEC v. Security National Bancorp Inc. and Wesley Godfrey, Jr.,*[5] alleging that Security National Bancorp (SNBI) and Wesley Godfrey, Jr., the chairman of the board and president of SNBI, failed to disclose in the Form 10-K filed by

SNBI for fiscal year 1988, among other things, material action taken by the Office of the Comptroller of the Currency; the resignation of SNBI's auditors; and the alteration of an auditor's report filed with the annual report. The defendants consented to the entry of injunctions. Godfrey, personally, was ordered to comply with his filing obligations under Sections 13(d) and 16(a) of the Exchange Act and Rules 13d-1 and 16a-1 thereunder by filing with the Commission a Schedule 13D, a Form 3, and a Form 4 disclosing his beneficial ownership of SNBI stock. Additionally, SNBI was ordered to file, and Godfrey was ordered to cause SNBI to file, a corrected annual report on Form 10-K for 1988 and delinquent current reports on Form 8-K.

Other cases include *SEC v. John E. Parigian,*[6] which involved the adequacy and timing of loan loss reserves of Capital Bancorporation in the second and third quarters of 1986. The defendant, a former officer and director of Capital Bancorporation, consented to the entry of a permanent injunction. In *SEC v. Jiro Yamazaki and Ikuko Sekiguchi-Yamazaki,*[7] Jiro Yamazaki, a former bank employee, and his wife were charged with trading securities while in possession of material nonpublic information, obtained by Yamazaki in the course of his employment, concerning a proposed tender offer. The defendants consented to the entry of an injunction and an order requiring them to pay about $100,000 in disgorgement, prejudgment interest, and civil penalties.

The new unit devoted to bank and thrift cases in the Division of Enforcement also serves as a liaison, both within the Commission and with the banking regulatory authorities, regarding securities law issues involving financial institutions. Through contacts with the federal financial supervisory agencies and law enforcement authorities, the Commission has sensitized the agencies to its enforcement concerns and the need for compliance with the federal securities laws. This has facilitated referrals of possible securities law

violations to the Division of Enforcement and grants of access to information in the Commission's nonpublic files to other law enforcement and bank regulatory agencies, as well as the development of training programs in the staff's areas of expertise. In addition, the Commission is a member of the National Interagency Bank Fraud Working Group, sponsored by the Department of Justice.

Penny Stock Cases

Penny stock cases constituted a significant part of the Commission's enforcement effort. Eighty-six of the Commission's enforcement actions were penny stock cases.

In *SEC v. Power Securities Corporation*[8] the Commission filed an injunctive action against two broker-dealers, Power Securities Corporation and Allied Capital Group, Inc., fifteen individual defendants, and five nominal defendants. The Commission's complaint alleges that various defendants violated Section 17(a) of the Securities Act, Sections 10(b) and 15(c) of the Exchange Act, and Rules 10b-5 and 15c1-2 thereunder. Among other things, the Commission's complaint alleges that Power, Allied, and other defendants violated the antifraud provisions by engaging in a fraudulent scheme of simultaneously recommending to customers both the sale of one security and the purchase of another for the purpose of increasing commissions.

The defendants in *Power* also allegedly charged more than $9.4 million in unlawful excessive mark-ups on the securities of six issuers and obtained illegal profits exceeding $10 million from the market manipulation of two securities. The Commission's complaint alleges that certain defendants engaged in insider trading that resulted in unlawful profits in excess of $1 million, for which the Commission is seeking disgorgement as well as $3 million in penalties under ITSA.

The Commission's complaint further alleges that Power and Allied maintained a secret working relationship, such that Allied was controlled by Power, or alternatively, such that the two firms were under common control, in violation of Section 15(b)(2) of the Exchange Act and Rule 15b3-1. The complaint also charges that one defendant, Henry Fong, engaged in prohibited securities transactions with or involving Equitex, Inc., a nominal defendant in the action, in violation of Sections 57(a)(l) and 57(a)(4) of the Investment Company Act of 1940 and Rule 17d-1. As of September 30, 1990, the Commission was in litigation with the defendants.

In *SEC v. Blinder, Robinson & Co., Inc.,*[9] the Commission filed an injunctive action against Blinder, its president, Meyer Blinder, and the firm's parent company, Intercontinental Enterprises, alleging that the defendants engaged in a fraudulent scheme to distribute and sell over one billion penny stock shares of 12 shell companies that had been the subjects of “blank check” public securities offerings. The Commission further alleged that, through fraudulent, high-pressure sales tactics, Blinder illegally distributed and sold these securities at prices that included undisclosed mark-ups ranging up to 140 percent, and that, as a result, the defendants realized illegal profits of more than $20 million. At the end of the fiscal year, litigation in this case was pending.

In *SEC v. Wellshire Securities, Inc.,*[10] the Commission filed an injunctive action against Wellshire, a major penny stock broker-dealer, several of its principals and employees, and two penny stock issuers and their principals. The complaint alleged that Wellshire was operating a penny stock boiler room that engaged in abusive and manipulative sales and trading practices. The Commission alleged that two penny stock issuers provided false and misleading information to Wellshire concerning their operational and financial condition, and that Wellshire disseminated this information to the

public. A temporary restraining order and asset freeze were granted against Wellshire, its two principals and a salesman, and a preliminary injunction was subsequently entered against Wellshire, its two principals, other individuals, and one of the issuers. The other penny stock issuer and its chief executive officer consented to permanent injunctive relief. Based on the court's findings, the NASD canceled Wellshire's membership, putting the firm out of business.

SEC v. Leonard M. Tucker[11] involved a major penny stock dealer, F. D. Roberts Securities, Inc., that had been enjoined in a previous Commission action. On November 20, 1989, the Commission filed an action against several of F.D. Roberts' principals and sales managers who allegedly engaged in market manipulation, induced aftermarket purchases during an initial public offering, and refused to execute customer sell orders. Three of the defendants had consented to preliminary injunctions and one defendant had consented to a permanent injunction as of the end of the fiscal year. Several defendants entered guilty pleas in related criminal cases brought by the United States Attorney in New Jersey.

The Commission brought an injunctive action against a public company, five individuals, and four trusts in *SEC v. Lifeline Healthcare Group, Ltd.*[12] for fraud in the sale of $100 million of Lifeline stock. The individual defendants were charged with creating an active over-the-counter (OTC) market for Lifeline stock by filing false and misleading reports with the Commission and issuing false reports to the public concerning the company's financial condition, business prospects, and the identities and holdings of major shareholders. A receiver was appointed by the court to take control of the company. One of the individual defendants, a former director of Lifeline, consented to a permanent injunction and disgorgement after the end of the fiscal year. At the time of his settlement, the litigation was pending against the other defendants.

In a follow-up to *SEC v. Arnold Kimmes,*[13] a major penny stock case filed during fiscal year 1989, the Commission obtained a permanent consent injunction against defendant Suzanne Bosworth, a former registered representative.[14] Bosworth allegedly opened nominee accounts to be used in an initial public offering, falsified brokerage accounts to hide true beneficial ownership, and participated in causing the issuers' common stock to trade at artificially high prices.

SEC v. San Marino Securities, Inc.[15] was the first injunctive action authorized under Exchange Act Rule 15c2-6, the Commission's new cold call rule, which, among other things, requires brokers and dealers to approve each customer's account for transactions in penny stocks by making and providing a written determination that penny stocks are suitable for the customer. The rule also requires the broker or dealer to obtain the customer's written agreement to initial penny stock purchases. The Commission alleged that San Marino failed to approve customer accounts for penny stock transactions, failed to receive written agreements from customers concerning such transactions, and lacked supervisory procedures to ensure compliance. San Marino consented to the entry of an injunction. The settlement of the case included a court ordered offer of rescission by San Marino for all transactions in which a Rule 15c2-6 violation occurred. Separate administrative proceedings against the firm and its president also were instituted and settled; the firm was ordered not to deal in designated securities for a 90-day period, and the president was suspended for a period of 30 days for his failure to supervise.

The Commission also filed an injunctive action against a now defunct penny stock broker-dealer, Monmouth Securities, Inc., and several of its former principals and employees for their alleged participation in a scheme with an issuer, Beres Industries, to take the company public in return for excessive and undisclosed underwriter's compensation.

The Commission's complaint alleged that Monmouth was provided with large amounts of the Rule 144 stock owned by Beres' chairman during aftermarket trading at a 50 percent discount and that the firm immediately resold the stock to clients and thereby obtained a profit of $3 million. The complaint also alleged that Monmouth and its principals manipulated the market for Beres, engaged in boiler room sales efforts, and that one salesman engaged in particularly abusive sales practices (*SEC v. Beres Industries, Inc.*[16]*).* These proceedings were pending as of September 30, 1990.

Market Manipulation

The Commission is charged with ensuring the integrity of trading on the national securities exchanges and in the OTC markets. The Commission staff, the exchanges, and the NASD engage in surveillance of these markets.

In April 1990, after protracted settlement negotiations, the Commission announced a settlement reached with Michael R. Milken, a defendant in *SEC v. Drexel Burnham Lambert Inc.*[17] The Commission's injunctive action against Drexel, Milken, and others was filed in September 1988 and alleged that the defendants had devised and carried out a scheme involving stock manipulation, fraud on the broker-dealer's own clients, failure to make required disclosures regarding the beneficial ownership of securities, insider trading, and numerous other securities law violations. The order entered against Milken enjoined him and required him to pay $400 million in civil disgorgement into a claims fund for the benefit of defrauded investors and other injured persons.[18] The order further provided that Milken would cooperate in the Commission's continuing investigation and would be barred in administrative proceedings. The order was entered simultaneously with Milken's guilty plea to six felony counts including conspiracy, securities fraud, aiding and

abetting the filing of a false document with the Commission, and aiding and abetting the failure to file a truthful and accurate Schedule 13D. In connection with his guilty pleas, Milken consented to pay an additional $200 million in criminal fines and penalties. In November 1990, Milken was sentenced on his guilty pleas to ten years imprisonment, three years probation, and community service.

Two enforcement actions involved dealings with Boyd L. Jefferies, former owner of Jefferies & Co., a broker-dealer. In 1987, Jefferies consented to an injunction and a bar from the securities industry based on Commission allegations of market manipulation and the "parking" of securities. In *SEC v. Salim B. Lewis,*[19] the Commission alleged that the defendant, the managing partner of a broker-dealer, entered into an agreement with Jefferies to manipulate the price of Fireman's Fund Corporation stock on the day American Express was to price an offering of Fireman's Fund securities. Pursuant to the agreement, Jefferies & Co. purchased Fireman's Fund common stock at the close, thereby causing the price to increase one-eighth of a point to close at $38. Lewis allegedly aided and abetted the making and keeping of inaccurate broker-dealer records in order to conceal the manipulation and the reimbursement of losses sustained by Jefferies & Co. as a result of its purchases. Lewis consented to the entry of an injunction and an order requiring him to disgorge $475,000. In related administrative proceedings, Lewis consented to the entry of a bar order.

In *SEC v. GAP Corporation and James T. Sherwin,*[20] the Commission alleged that GAF Corporation and its vice chairman had entered into an agreement with Jefferies by which Jefferies & Co. would close the price of Union Carbide common stock at $22 or higher. At the time, GAF was negotiating to sell a block of Union Carbide stock, and bids for the block were to be based on the market price. As part of the alleged agreement, the defendants promised to pay Jefferies & Co.

for any losses sustained as a result of its manipulative activities. The defendants consented to be enjoined and GAF was ordered to disgorge $1,250,000, plus prejudgment interest. In related administrative proceedings, a Jefferies & Co. employee who participated in the Union Carbide manipulation consented to a six-month suspension *(In the Matter of James T. Melton*[21]).

In *SEC v. Michael Kaufman,*[22] the Commission alleged that the defendant, the majority shareholder, secretary, and chairman of ATI Medical, Inc. manipulated the market for ATI's stock. The defendant effected numerous purchases and sales of ATI stock through many brokerage accounts in his own name and in the names of four nominees to create the appearance of active trading. Kaufman consented to the entry of an injunction and agreed to disgorge $180,331.05.

In *SEC v. Novaferon Labs, Inc.*,[23] the Commission alleged that increases in the price of the common stock of Novaferon Labs occurred as a result of a manipulation accomplished through the filing and dissemination of numerous fraudulent reports with the Commission and press releases to the public. The reports and press releases allegedly provided false and misleading information concerning, among other things, the company's financial condition, business prospects, and the identities and holding of major shareholders. At the end of the fiscal year, the litigation in this case was pending.

Insider Trading

Insider trading refers generally to abuses of nonpublic information in the securities markets. It encompasses more than trading and tipping by traditional insiders, such as officers and directors, who are subject to a duty to disclose any material, nonpublic information or abstain

from trading in the securities of their own company. Insider trading also includes the unlawful transmission or use of material, nonpublic information by persons in a variety of other positions of trust and confidence and by those who misappropriate such information. Insider trading cases are varied and, over the years, Commission actions have included as defendants investment bankers, risk arbitrageurs, attorneys, law firm employees, accountants, bank officers, brokers, financial reporters, and even a psychiatrist. Most insider trading cases are brought under the general antifraud provisions of the securities laws—particularly Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. Exchange Act Rule 14e-3, promulgated under the Williams Act, separately proscribes most trading by persons possessing material, nonpublic information concerning a tender offer.

The Commission ordinarily seeks permanent injunctions and ancillary relief, including disgorgement of any profits gamed or losses avoided, against alleged violators. The penalty provisions of the Insider Trading Sanctions Act of 1984, as amended by the Insider Trading and Securities Fraud Enforcement Act of 1988 and now codified in Section 21A of the Exchange Act, authorize the Commission to seek a civil penalty, payable to the United States, of up to three times the profit gained or loss avoided, against persons who unlawfully trade in securities while in possession of material, nonpublic information, or who unlawfully communicate material, nonpublic information to others who trade. Civil penalties also can be imposed upon persons who control insider traders.

Each year, the Commission devotes considerable staff resources to detecting, investigating, and litigating insider trading cases. During the fiscal year, the Commission brought 38 civil and administrative actions alleging insider trading violations.

Several of the cases brought by the Commission alleged abuse of material, nonpublic information by attorneys, in *SEC v. Steven L. Glauberman,*[24] the Commission alleged that an associate in a major New York law firm sold information to a registered representative concerning approximately 29 actual or proposed corporate transactions such as mergers and acquisitions. The Commission alleged that the representative traded for his own account, for customer accounts, and in a special account for Glauberman. By the end of the fiscal year, most of the defendants had consented to injunctions and agreed to disgorge a total of $1,773,092.70. Three participants also consented to bars in administrative proceedings under Section 15(b)(6) of the Exchange Act. At the end of the fiscal year, the injunctive action was pending as to other defendants.

The Commission also brought a case entitled *SEC v. Saul Bluestone,*[25] alleging that several members of a Detroit law firm sold Zenith stock while they possessed material, nonpublic information concerning a loan default and impending bankruptcy petition. Bluestone allegedly learned the information as a member of Zenith's board of directors and disclosed that information to several of his law partners, all of whom sold Zenith stock. Three of the attorneys consented to injunctions and disgorged a total of $64,582.29, plus prejudgment interest and penalties. The litigation against two other partners was continuing at the close of the fiscal year.

In *SEC v. James H. O'Hagan,*[26] the Commission alleged that O'Hagan, then a partner in a prominent Minneapolis law firm, traded in the securities of The Pillsbury Company while he possessed material, nonpublic information concerning a hostile tender offer for Pillsbury. O'Hagan's firm served as local counsel for the offeror. The complaint alleged that O'Hagan discussed the impending offer with another partner and that O'Hagan purchased Pillsbury options and stock after he learned of the offer. Following the announcement,

O'Hagan sold the securities, realizing a profit of approximately $4.3 million. The district court denied a motion for summary judgment by O'Hagan, and the Commission litigation against O'Hagan was continuing at the close of the fiscal year.

The Commission also continued to initiate actions arising out of mergers and acquisitions. In June, for example, the Commission filed *SEC v. Alan C. Goulding.*[27] The complaint alleged that Goulding, formerly a senior officer of A&P, learned that the company was preparing to make several major acquisitions, and that he tipped several friends and business associates concerning the acquisitions and an impending favorable earnings announcement by A&P. When the action was filed, the defendants consented to the entry of injunctions. They also agreed to disgorge profits of $513,881.23 and interest in the amount of $189,879.97. In addition, they agreed to pay ITSA penalties totalling $1,300,131.25.

Financial Disclosure

Actions involving false and misleading disclosures concerning the financial condition of companies and the issuance of false financial statements are often complex and require more resources than other types of cases, but their effective prosecution is essential to preserving the integrity of the disclosure system. The Commission brought 24 cases containing significant allegations of financial disclosure violations against issuers, regulated entities, or their employees. Many of these cases included alleged violations of the accounting provisions of the Foreign Corrupt Practices Act. The Commission also brought 11 cases alleging misconduct by accounting firms or their partners or employees.

A number of cases involved the improper recognition of revenue or income. In *SEC v. Richard H. Towle,*[28] the Commission filed a

complaint alleging that the defendants engaged in activities that resulted in Thortec International, Inc. filing materially false and misleading financial statements with the Commission. The defendants, all former executive officers of Thortec, allegedly recorded unsupported adjustments to the amount of revenue reported by Thortec's regional offices during the process of preparing the company's financial statements and periodic reports. Thus, the financial statements filed with the Commission materially overstated revenue and earnings. The proceeding was still pending at the close of the fiscal year.

In *SEC v. Barry J. Minkow,*[29] the Commission filed an injunctive action against 14 defendants with regard to their fraudulent conduct in connection with misrepresentations contained in financial statements and registration statements filed with the Commission in October and November 1986 by ZZZZ Best, Inc., to facilitate a public offering of stock in which $15 million was obtained from investors. With the exception of two defendants, each of the defendants has consented to entry of an order permanently enjoining him from the violations of the Securities Act and Exchange Act. The case against the other two defendants was pending as of the close of the fiscal year. Minkow also was criminally convicted of 57 counts for crimes he committed while chairman, president, and chief executive officer of the company. He is serving a sentence of 25 years.

Numerous other actions brought by the Commission involved alleged fraudulent misrepresentations or omissions in financial statements that were filed by issuers with the Commission or otherwise disseminated to the public (*SEC v. Fluid Corporation,*[30] *SEC v. Rajiv P. Mehta,*[31] *SEC v. Crowell & Co., Inc.,*[32] and *SEC v. Malibu Capital Corporation*[33]).

A number of accountants were suspended from practicing before the Commission in Rule 2(e) proceedings based on allegations of significant audit failures *(In the Matter of Stephen L. Hochberg, CPA;*[34]*In the Matter of Charles C. Lehman, Jr., CPA*;[35] *In the Matter of William G. Gaede, Jr., CPA*;[36] and *In the Matter of Georgia McCarley**[7]*).* Accountants enjoined for allegedly aiding and abetting violations of the registration and antifraud provisions by their preparation and audit of financial statements in connection with securities offerings also were the subject of suspension orders *(In the Matter of Bruce T. Anderson, CPA*[38] and *In the Matter of Charles V. Moore, CPA*[39]*).*

Corporate Control

The Commission's enforcement program also scrutinizes corporate mergers, takeovers and other corporate control transactions, and the adequacy of disclosures made by acquiring persons and entities and their targets. The Commission recently has brought cases involving Sections 13 and 14 of the Exchange Act, which govern securities acquisition, proxy, and tender offer disclosure. Increasingly, the Commission seeks orders requiring violators to disgorge any profits obtained from the violation.

The Commission was active in pursuing cases alleging tardy or inadequate disclosure under Section 13(d). In one case, *SEC v. Nortek, Inc.,*[40] the Commission filed an injunctive action against Nortek, Inc. and three of its officers under both Sections 13(d) and 10(b) of the Exchange Act and Rules 10b-5 and 13d-1 thereunder. According to the complaint, Nortek filed a late and misleading Schedule 13D concerning its accumulation of five percent of the outstanding stock of Rexham Corp. Notwithstanding its obligation to file a Schedule 13D, Nortek continued to accumulate Rexham stock, buying an additional 62,000 shares after the filing obligation accrued.

The complaint alleged that Nortek purchased while it withheld from the market required information about its five percent accumulation. The defendants consented to injunctions against future violations. In addition, Nortek agreed to disgorge $503,000 in profits from its Rexham purchases.

In *SEC v. Edward P. Evans,*[42] the Commission filed an action against present or former senior officers of Macmillan, Inc. According to the complaint, the defendants developed a plan to recapitalize Macmillan in anticipation of a possible hostile takeover. The proposal called for Macmillan's employee stock option plan to buy more than five percent of the company's shares. The Schedule 13D allegedly failed to disclose that a purpose of the acquisition was to further a recapitalization planned or proposed by the defendants. The defendants consented to the entry of a final judgment of permanent injunction against them.

In *SEC v. Alan E. Clore,*[42] the Commission alleged that an investor failed to update previous disclosures to reflect his intent to take a company private. Clore, formerly the chairman of Kaisertech Ltd., and foreign corporations that he controlled accumulated a control block of Kaisertech without amending statements made in a previously filed Schedule 13D to disclose plans Clore allegedly had made to try to take the company private. The complaint also alleged that Clore failed to make disclosures concerning his purchases and sales on Form 4 as required by Section 16(a) of the Exchange Act and Rule 16a-1 thereunder. The defendant consented to the entry of an injunction.

In *SEC v. Thomas Lee Oakes,*[43] the Commission alleged violations of the proxy solicitation rules. According to the complaint, Oakes solicited proxies from shareholders of North Atlantic fisheries in violation of the Commission's rules. The complaint alleged that Oakes

failed to file his proxy materials with the Commission; misrepresented, among other matters, that he was the company's chief financial officer; and failed to comply with various rules prescribing the form of the proxies. Oakes consented to a permanent injunction.

The Commission also makes use of other provisions of the securities laws to police acquisition-related conduct. For example, in *SEC v. Mesa Limited Partnership and T. Boone Pickens,* Jr.,[44] the Commission filed an action alleging that Pickens and Mesa violated Sections 17(a)(2) and 17(a)(3) of the Securities Act through sales of stock and options of Homestake Mining. The complaint alleged that Mesa had publicly announced an offer to acquire Homestake in a negotiated transaction. The announcement disclosed that Mesa had acquired 3,540,000 shares of Homestake, or 3.8 percent of Homestake's outstanding common stock, and that Mesa was offering to acquire all of Homestake's remaining stock. According to the complaint, Mesa and Pickens decided to sell a substantial part of Mesa's holdings of Homestake stock and, after the release of the news announcement, began selling Homestake stock and options. The complaint alleged that Mesa failed to issue a release correcting or updating the initial release by disclosing Mesa's intention to sell Homestake securities. Mesa and Pickens consented to final judgments enjoining them from future violations and requiring Mesa to disgorge $2.3 million in profits.

Securities Offering Cases

Securities offering cases represent a significant portion of the Commission's enforcement activities. These cases involve the offer and sale of securities in violation of the registration provisions of the Securities Act. In some cases, the issuers attempt to rely on exemptions to registration requirements that are not available.

Offering cases frequently involve material misrepresentations concerning, among other things, use of proceeds, risks associated with investments, disciplinary history of promoters or control persons, business prospects, promised returns, success of prior offerings, and the financial condition of issuers.

In *SEC v. American Assurance Underwriters Group, Inc.,*[45] the Commission alleged that the defendants sold unregistered OTC securities, raising approximately $6 million. The issuer inflated its financial statements by recording at face value a note from a related party with no ability to pay. Four defendants consented to injunctions, a default final judgment was entered against another defendant, and, at the end of the fiscal year, the Commission was litigating against the remaining three defendants. The company, which filed for bankruptcy, consented to an injunction through its bankruptcy trustee.

The Commission's complaint in *SEC v. Charles A. Oglebay*[46] alleged that from May 1983 through November 1987 eight defendants fraudulently offered and sold $57 million of unregistered securities to 800 investors. The securities were marketed as small equipment leases, investment pools for leases, and notes purportedly backed by leases. The leases were supposed to generate rental income that would be remitted to the investors. Defendants allegedly made materially misleading statements as to, among other things, title and assignment of collateral, the existence of cash reserves and insurance, the default rate of the leases, the nature of the investments, the degree of risk, and the receipt of commissions. As of September 30, 1990, the Commission was in litigation with the defendants.

The Commission filed an injunctive action, *SEC v. RL Kotrozo, Inc.,*[47] against a registered investment adviser/broker-dealer and its two principals, alleging that from 1985 through at least July 1989 the

defendants engaged in the fraudulent offer and sale of securities in the form of promissory notes and interests in a non-existent mutual fund. The Commission alleged that, besides misrepresenting the existence of the mutual fund, the defendants misrepresented their financial condition, the risks of the investment, and the actual use of the funds. The Commission also alleged that investor funds were commingled with the personal funds of the principals and used to pay their personal expenses, as well as to repay earlier investors. The defendants consented to injunctions and agreed to disgorge $977,976.

The Commission filed an injunctive action against seven defendants in *SEC v. Donald Bader*[48] for raising approximately $9 million from 450 investors through the sale of unregistered securities in the form of investment contracts and promissory notes between May 1985 and May 1988. The Commission alleged that numerous material misrepresentations were made to investors concerning, among other things, the use of investor proceeds, the identity of control persons of the company, the existence of a state investigation, and the existence of substantial losses from uncollectible accounts. The defendants consented to injunctions. At the end of the fiscal year, the issue of disgorgement remained before the court.

In *SEC v. ALIC Corp.,**[9] the Commission brought an injunctive action against ALIC Corp. and its four principal officers alleging registration and antifraud violations in the sale of investment contracts, debentures that were represented to be certificates of deposit, preferred stock, and single premium annuities. Defendants raised over $17 million from over 1,000 investors, mostly senior citizens, and allegedly misrepresented the risks and returns of the securities, the guaranteed nature of the securities, and the financial condition of ALIC Corp. A receiver for ALIC Corp. was appointed by the court. At

the close of the fiscal year, the Commission was engaged in discovery and litigation with the defendants.

The Commission brought several actions against individuals and entities allegedly involved in the unregistered and fraudulent sale of interests in oil and gas wells, fractional undivided working interests, and limited partnership interests. Some of these actions include *SEC v. William A. Thorne;*[50] *SEC v. Profit Enterprises, Inc.;*[51] *SEC v. Transwestern Oil and Gas Co., Inc.;*[52] and *SEC v. Thomas Hydrocarbons, Inc.*[53]

Broker-Dealer Violations

The Commission filed a series of enforcement actions against broker-dealers. Broker-dealer cases generally involve fraudulent sales practices, net capital and customer protection violations, as well as violations of the books and records provisions.

The Commission continued to devote extensive resources to the litigation *In the Matter of The Stuart-James Co., Inc.,*[54] which was instituted in fiscal year 1989. The case was brought against one of the nation's largest penny stock broker-dealers and involves allegations of excessive undisclosed mark-ups on the first day of aftermarket trading in the securities of two issuers for which Stuart-James acted as sole underwriter; alleged abusive sales practices, including fraudulent telephone scripts, tie-in sales, planned cross trades, and undisclosed “no net selling” policies; and alleged failures to supervise.

The Commission filed an action against Thomas James Associates, Inc., a broker-dealer, the two registered principals and owners of the firm, and the firm's head trader. The Commission's complaint alleged that, in connection with Thomas James' underwriting of the initial

public offerings for four issuers, the defendants engaged in a scheme by which the firm's undisclosed domination and control of the market and fraudulent and high pressure sales tactics created an artificially large demand for the issuers' shares. Clients of the firm also were allegedly charged excessive undisclosed mark-ups. Brian Thomas, the registered principal, president, and 50 percent owner of the firm, consented to the entry of an injunction that included a bar from employment in the securities industry. In connection with the court's final order in this case, the Commission obtained a $1.5 million order for disgorgement to be paid by various defendants (*SEC v. Thomas James Associates, Inc.*[55]*).* In connection with the same violative conduct, the Commission instituted administrative proceedings against the former head trader at Thomas James.[56] As of the end of the fiscal year, those proceedings were pending.

Several actions were brought by the Commission alleging misappropriation of customer funds. In *SEC v. Oscar Ayala,*[57] the Commission obtained an injunction against a registered representative who allegedly engaged in unauthorized trading and misappropriated at least $2.4 million of customer funds for his personal use. At the end of the fiscal year, the issue of disgorgement was being litigated. The Commission issued a bar order against a registered representative who allegedly misappropriated in excess of $1 million from customers for his personal use and who had been previously enjoined for such conduct *(In the Matter of Walter F. Kusay, Jr.*[58]*).* An injunction was entered against a broker-dealer and its president and sole owner who sold customer securities and allegedly misappropriated at least $825,000, as well as violated net capital and broker-dealer books and records provisions (*SEC v. H.A. Kenning Investments, Inc. and Harry A. Kenning, Jr.*[59]*).* Administrative proceedings against H.A. Kenning, the president, resulted in a bar order *(In the Matter of Harry A. Kenning,* Jr.[60]). An injunction was also obtained by the Commission against a registered

representative who allegedly misappropriated approximately $2,028,407 from customers and obtained approximately $300,000 through the fraudulent sale of unregistered securities (*SEC v. Bruce Black*[61]*).*

The Commission also pursued broker-dealers and registered representatives for material misrepresentations and omissions made to customers in the offer and sale of securities. An injunction was obtained by the Commission against a registered representative of a broker-dealer for alleged misrepresentations he made in the offer and sale of notes issued by Phoenix Aviation, Inc. concerning, among other things, the business opportunities of the issuer and its financial and operating condition (*SEC v. Phoenix Aviation, Inc.*[62]*).* The Commission instituted administrative proceedings against the registered representative, which were pending as of the end of the fiscal year *(In the Matter of Alan R.* Aster[63]). Injunctions were entered against a broker-dealer and its president and sole owner based on their offer and sale of unregistered securities and their alleged misrepresentations to investors of the risks associated with the investment, the return on the investment, and the uses to which investors' funds would be put. In addition to entry of the injunctions, the firm's broker-dealer registration was revoked and the president was barred (*SEC v. Jeffers Investments Corporation*[64] and *In the Matter of David K. Jeffers and Jeffers Investments Corporation*[65]*).* Administrative proceedings were instituted against a broker-dealer and its principal for allegedly selling unregistered securities through the use of materially false and misleading statements concerning the ownership, financial condition, and business prospects of the issuer *(In the Matter of V.F. Minton Securities, Inc. and Vernon F. Minton*[66]*).* These proceedings were pending at the end of the fiscal year.

An injunction was entered against a government securities broker-dealer for the firm's alleged failure to maintain sufficient net capital,

comply with recordkeeping requirements relating to net capital computations, prepare and file financial reports with the Commission, comply with telegraphic notice requirements, and become a member of a national securities exchange registered under Exchange Act Section 6 or a securities association registered with the Commission under Exchange Act Section 15 A (*SEC v. Frank Clarke and Co., Inc.*[67]*).* In addition to entry of the injunction, the broker-dealer's registration was revoked *(In the Matter of Frank Clarke and Co., Inc.*[68]*).* Another government securities broker-dealer's registration was revoked by the Commission *(In the Matter of Stotler and Co.*[69]*)* based on allegations that Stotler effected transactions in government securities without becoming a member of a national securities exchange or the NASD; and failed to comply with regulations promulgated by the Department of the Treasury with respect to: (1) the maintenance of net capital; (2) the deposit of customer funds in a special reserve bank account; (3) recordkeeping; (4) the filing of financial reports with the Commission; and (5) the provision of telegraphic notice to the Commission of its net capital deficiency.

The Commission brought administrative proceedings against Donaldson, Lufkin & Jenrette Securities Corp. and a managing director for alleged practices in which the firm, from 1982 through April 1989, used its customers' margin securities in hundreds of transactions for its own benefit and without the customers' knowledge or consent. The managing director supervised the division that engaged in the practices, which generated $5.9 million in revenues for the firm. The Commission censured the firm and ordered that it comply with undertakings that included review of its practices and procedures in connection with the handling of customer securities, preparation and implementation of policies and procedures to effect compliance with the federal securities laws, and establishment of a fund of $5.6 million, plus prejudgment interest, for the repayment of customers. The managing director was suspended from association

with a regulated entity for 45 days and from supervisory responsibilities for 18 months *(In the Matter of Donaldson, Lufkin & Jenrette Securities Corporation*[70]*).*

The Commission also instituted administrative proceedings against registered broker-dealers, their principals and other firm personnel for failure to reasonably supervise individuals subject to their supervision in order to prevent violations of the securities laws. In *In the Matter of Gary W. Chambers,*[71] the Commission suspended a broker-dealer's senior vice president for compliance and operations for allegedly failing to supervise two registered representatives who engaged in excessive and unsuitable trading in customer accounts. The Commission also censured a broker-dealer in *In the Matter of Goodrich Securities, Inc.*[72] and ordered the firm to review its supervisory and compliance procedures and to revise such procedures in order to ensure adequate supervision.

Investment Adviser Violations

The Commission instituted several significant enforcement actions involving investment advisers. These cases included abusive sales practices and misappropriation of client funds.

In *SEC v. Michael S. Douglas,*[73] the Commission alleged that an unregistered investment adviser made material misrepresentations in connection with the offer and sale of interests in three unregistered investment companies controlled by the adviser. The Commission obtained a temporary restraining order enjoining further antifraud violations, freezing the defendant's assets, and appointing a receiver to take control and account for at least $21 million of investor funds.

An injunction was obtained against another registered investment adviser and its principal for allegedly engaging in a scheme to hide

trading losses from an investment advisory client by sending false account statements reporting fictitious securities transactions to hide commodity trading losses of about $149,000 (*SEC v. Gregory D. Gown*[74]*).* In a related administrative proceeding, the adviser's registration was revoked and the principal barred *(In the Matter of Liberty Securities Group, Inc. and Gregory D. Govan*[75]*).*

In *SEC v. U.S. General Corporation,*[76] the Commission brought an emergency trading suspension and injunctive action against a registered investment company and six individuals for allegedly grossly overvaluing the fund's assets in Commission filings and promotional materials distributed to the public. A substantial number of shares were sold based upon the false information. Two of the individual defendants have disgorged $20,304.90 to the Commission.

Administrative proceedings were brought against two investment advisers for the dissemination of impermissible performance advertisements. One investment adviser allegedly made material misrepresentations concerning the profitability of its recommendations and trades, and the other investment adviser allegedly made misrepresentations in a $10 million advertising campaign that attracted $1 billion of new investor funds *(In the Matter of Blue Chip Market Advisor, Inc. and James Paul Azzalino*[77] and *In the Matter of Fred Alger Management, Inc.,*[78] respectively). Both advisers were censured and ordered to comply with certain remedial undertakings. In another advertisement case, an investment adviser allegedly promoted a company's common stock through the use of materially false and misleading advertisements and newsletters, traded in the securities, and obtained illegal extensions of credit from brokers and dealers (*SEC v. William P. Dillon* [79]*).* The adviser consented to the entry of the injunction and was ordered to make restitution of $350,000.

Proceedings instituted against two advisers involved application of the Commission's 1986 interpretive release concerning the scope of Exchange Act Section 28(e), which provides a safe harbor for money managers who use commissions generated by account transactions to pay for research and brokerage services (referred to as soft dollars). Among other things, the release clarified the Commission's interpretation of Section 28(e), expressed the Commission's views regarding the best execution obligations of fiduciaries for client transactions, and discussed various disclosure obligations. *In the Matter of Patterson Capital Corporation and Joseph P. Patterson*[80] involved a registered investment adviser and two principals who allegedly made secret use of their clients' commissions to purchase various marketing services for the sole benefit of the adviser, in breach of their fiduciary duties. Similarly, another investment adviser allegedly engaged in an undisclosed brokerage allocation practice which involved obtaining client referrals for its advisory business through the use of its mutual fund client's brokerage commissions *(In the Matter of Stein Roe & Farnham Incorporated*[81]*).* The respondents in both proceedings consented to the findings of the violative conduct, censures, and remedial undertakings.

An investment adviser which allegedly failed to disclose multimillion dollar benefits it was earning on client funds and inadequately disclosed arrangements that permitted it to earn multiple advisory fees was the subject of an administrative proceeding. The adviser was censured and ordered to comply with certain undertakings *(In the Matter of Thomson McKinnon Asset Management L.P.*[82]). In *SEC v. R.E.C. Investors, Inc.,*[83] the Commission obtained an injunction and instituted proceedings against an investment adviser and its principal for allegedly engaging in a free-riding scheme, purchasing $150 million in securities in violation of the margin rules, and earning profits of $2.65 million. The defendants consented to the injunction and were

ordered to make disgorgement. In related administrative proceedings, they were censured and ordered to comply with certain undertakings.

Investment Company Violations

In a significant action involving a registered investment company, *SEC v. Municipal Lease Securities Fund Inc.,*[84] the Commission obtained emergency injunctive and ancillary relief against four defendants, a control person, a broker-dealer, an investment adviser, and an investment company. The Commission's complaint alleged antifraud, pricing, and books and records violations of the Investment Company Act. This case primarily involved selling and redeeming the registered investment company's shares during a period in which it was not calculating its net asset value on a daily basis. The court entered an order restraining sales, redemptions and repurchases of the fund's shares, freezing the fund's assets, enjoining the destruction of the fund's books and records, and appointing a receiver to determine the future operation of the fund.

A permanent injunction was entered against Dart Group Corporation for allegedly acting as an unregistered investment company. Dart Group engaged in the business of investing, reinvesting, and trading in securities of several public companies that it had announced an intention to acquire. The defendants consented to the injunction and undertook to report to the Commission for a three-year period information concerning their investments and income derived from those investments (*SEC v. Dart Group Corporation*[85]).

The Commission brought an injunctive action against Fluid Corporation, a business development company regulated by both the Commission and the Small Business Administration. Fluid Corporation, among other things, allegedly made misleading disclosures in an annual report concerning its financial condition and

omitted information regarding its subsidiary's capital impairment and reissued audit opinion (*SEC v. Fluid Corporation*[86]*).* Fluid consented to the entry of an order by which the registration of its common stock under the Exchange Act and its election to operate as a business development company under the Investment Company Act were revoked. At the end of the fiscal year, the action against the remaining defendant was pending.

Sources for Further Inquiry

The Commission publishes the SEC *Docket,* which includes announcements regarding enforcement actions. The Commission's litigation releases describe civil injunctive actions and also report certain criminal proceedings involving securities-related violations. These releases typically report the identity of the defendants, the nature of the alleged violative conduct, the disposition or status of the case, as well as other information. The SEC *Docket* also contains Commission orders instituting administrative proceedings, orders making findings and imposing sanctions in those proceedings, and the initial decisions of Administrative Law Judges in Commission proceedings.

OFFICE OF INTERNATIONAL AFFAIRS

In December 1989, Chairman Richard Breeden announced the creation of the Commission's Office of International Affairs (OIA). OIA has primary responsibility for the negotiation and implementation of information-sharing agreements and for developing legislative and other initiatives to facilitate international cooperation. OIA coordinates and assists in making requests for assistance to, and responding to requests for assistance from, foreign authorities. OIA also addresses other international issues that arise in litigated matters such as effecting service of process abroad and gathering foreign-based evidence using various international conventions, freezing assets located abroad, and enforcing judgments obtained by the Commission in the United States against foreign parties. In addition, OIA operates in a consultative role regarding the significant ongoing international programs and initiatives of the Commission's other divisions and offices.

Key 1990 Results

The Commission entered into its two most comprehensive agreements on cooperation during fiscal year 1990. The Commission and the Ministry of Finance of the Netherlands, on behalf of their respective governments, signed an agreement on Mutual Administrative Assistance in the Exchange of Information in Securities Matters (Netherlands Agreement); and the Commission and its counterpart in France, the Commission des Operations de Bourse (COB), signed an Administrative Agreement (French Agreement). Both of those agreements provide for comprehensive

assistance in securities matters. The Commission also signed an understanding with the COB (French Understanding) in which the parties agreed to consult about matters of common interest to coordinate market oversight and resolve possible differences between their regulatory systems.

The Commission entered into an understanding with the Institute Monetaire Luxembourgeois of Luxembourg (Luxembourg MOU), which provides for the signatories to exchange information relating to trades cleared through a foreign clearing organization for the PORTAL trading system. The Commission entered into its first technical assistance understanding with the Republic of Hungary State Securities Supervision and the Budapest Stock Exchange (Hungary Understanding) which lays the groundwork for the Commission's providing technical assistance to Hungary regarding the development of Hungary's securities markets. At the conclusion of the first Trilateral Meeting, hosted by the Commission, a precedent setting communiqué was issued in which the parties (the United Kingdom Department of Trade and Industry and Securities and Investments Board, and the Securities Bureau of the Ministry of Finance of Japan) stated their agreement about several important regulatory matters and their commitment to consult and coordinate with each other about matters of mutual concern.

Arrangements for Mutual Assistance and Exchanges of Information

The increasing internationalization of the world's securities markets has raised many new and complex issues that impact upon the Commission's ability to enforce the United States federal securities laws. For example, a central problem the Commission now faces is collecting information located abroad. The Commission has

attempted to resolve this problem by developing information-sharing arrangements on a bilateral basis with various foreign authorities.

The information-sharing arrangements allow the Commission to obtain evidence located abroad while avoiding the conflicts that may result from differences in legal systems. The Commission has entered into various arrangements with foreign authorities in Switzerland, Japan, the United Kingdom, three provincial authorities in Canada, Brazil, Italy, the Netherlands, France, and Luxembourg. These arrangements have proven to be effective means for obtaining information and developing cooperative arrangements between regulators. In addition, the staff coordinates closely with the regulators with whom it has information-sharing arrangements to develop ways to implement and improve the arrangements. The Commission also cooperates on an informal basis with foreign regulators with whom it does not have explicit information-sharing arrangements.

On December 11, 1989, the Commission and the Ministry of Finance of the Netherlands, on behalf of their respective governments, signed the Netherlands Agreement, which provides for comprehensive assistance in securities matters. The comprehensive assistance provisions of the Netherlands Agreement are implemented for the Commission by the amendments contained in Section 6 of the Insider Trading and Securities Fraud Enforcement Act of 1988 (ITSFEA). Unlike the Commission's previous Memoranda of Understanding (MOU), the Netherlands Agreement is a binding agreement under international law as opposed to a statement of intent to cooperate.

On December 14, 1989, the Commission and the COB signed the French Agreement, which is similar to the Netherlands Agreement both in its comprehensive scope and in its status as a binding agreement. The French Agreement provides that the Commission

and the COB may utilize their respective compulsory powers to assist each other in matters within the scope of the MOU, as authorized, respectively, by ITSFEA and by the French Law of August 2, 1989.

Contemporaneously with the signing of the French Agreement, the Commission and the COB signed the French Understanding, which goes well beyond the provisions of the French Agreement and represents a significant new step in international cooperation in securities matters. The French Understanding reflects the agreement of the Commission and the COB to engage in mutual consultations about subjects of common interest in order to coordinate market oversight and to resolve differences that may exist between their respective regulatory systems. The French Understanding is the first formal understanding between the Commission and a foreign securities authority on matters beyond the enforcement of the securities laws. It provides a framework for the two authorities to take proactive steps to address a wide range of issues concerning the stability and integrity of the United States and French securities markets.

On May 23, 1990, the Commission signed the Luxembourg MOU with the Institut Monetaire Luxembourgeois (IML), which provides for the exchange of information between the Commission and the IML relating to trades cleared through Centrale de Livraison de Valeurs Mobilieres, S.A. Luxembourg for the PORTAL trading system.

The Commission entered into a MOU with the Comision Nacional de Valores (CNV) on October 18, 1990. The MOU with the CNV is broad in scope, and it encompasses not only assistance in enforcement matters, but also the provision of technical assistance. The MOU also contemplates consultations about all matters relating to the operation of the securities markets in the United States and Mexico.

Trilateral Communiqué

On September 21, 1990, the Commission and the United Kingdom Department of Trade and Industry and Securities and Investments Board, and the Securities Bureau of the Ministry of Finance of Japan, met for the first time on a trilateral basis to consider issues of importance to the world's three largest securities markets. At the conclusion of their meetings, the parries issued a trilateral communiqué in which they stated their:

• intention to continue to coordinate their efforts to maintain safe and sound securities markets;

• agreement that there is a need to maintain balance between the stock and derivative markets to avoid adverse effects on the stability of the stock markets, and their belief that margin levels and derivative instruments should reflect the public interest in safe and resilient markets;

• intention to encourage cross-border business between their markets by pursuing mutual recognition of regulatory systems;

• agreement on the desirability of regularly exchanging information to facilitate the monitoring of multinational firms with operations in their respective capital markets;

• intention to utilize fully their domestic powers to assist each other in the oversight of their respective domestic markets and the enforcement of their respective securities laws; and

• intention to meet regularly on a trilateral basis to continue discussions about matters of mutual interest.

Technical Assistance

The Commission is actively involved in providing technical assistance to other countries concerning the development and regulation of their securities markets. On May 25, 1990, Chairman Richard Breeden announced the establishment of the Commission's Emerging Markets Advisory Committee (EMAC) to advise the Commission on how best to utilize its resources for assisting foreign regulators, and to provide technical and other assistance to the Commission regarding requests from governmental authorities for assistance in developing securities and other financial markets. The EMAC is intended to ensure that the United States is in a position to provide strong and effective leadership to emerging markets. The first meeting of the EMAC took place on June 12, 1990.

On June 22, 1990, the Commission entered into an understanding with the Republic of Hungary State Securities Supervision and the Budapest Stock Exchange regarding the provision of technical assistance for the development of the Hungarian securities markets in which the Commission formally states its willingness to provide technical assistance to Hungary “with a view to establishing and implementing an ongoing technical assistance program for the development, administration, and operation of the Hungarian securities markets.” The signatories also expressed their intention to use their best efforts to assist each other in the administration and enforcement of their respective securities laws and regulations. The Commission also has created the International Institute for Securities Market Development (Institute) to provide training for foreign government officials that are responsible for the development or regulation of emerging securities markets. The Institute is intended to further market development, capital formation, and the building of sound regulatory structures in countries engaged in such efforts. The

Institute's first seminar and consultation program will be held in the spring of 1991. The faculty of the Institute will consist of senior Commission officials, experts from self-regulatory organizations, and members of the EMAC.

International Organizations

During 1990, the Commission participated in the following international organizations.

The International Organization of Securities Commissions (IOSCO). The Commission is an active participant in the work of IOSCO. In fiscal year 1990, the Commission chaired lOSCO's Executive Committee and prepared a strategic assessment of lOSCO's Technical Committee, which reviewed both the structure and operation of that committee and made recommendations for how it should operate in the future. The strategic assessment was adopted by IOSCO and the Commission was elected to chair the Technical Committee for fiscal year 1991.

The Organization for Economic Cooperation and Development (OECD). The Commission staff participated in discussions at the OECD regarding the establishment of international standards governing foreign corrupt practices; the OECD Codes relating to securities matters; and accounting issues.

The Group of Negotiations on Services to the General Agreements on Tariff and Trade (GATT). The Commission is an active participant in the effort, through the Uruguay Round of the GATT, to establish a multilateral framework of principles and rules for trade in financial services. The Commission also consulted with the Office of the United States Trade Representative and other United States

government agencies in connection with the negotiation of other international trade and investment agreements.

The Wilton Park Group. This organization is sponsored by the United Kingdom Department of Trade and Industry. The staff participated in extensive discussions to facilitate methods for enhancing the exchange of information among securities regulators.

The Commission also has been involved with other United States governmental agencies in reviewing the plans and directives of the European Economic Community, which is working toward achieving an internal market among its twelve-member countries by December 31, 1992 (referred to as EC 92). The Commission has been involved in several different studies, and provided assistance to other United States government agencies, including the Department of the Treasury, in connection with the impact of EC 92 on the United States financial services markets.

REGULATION OF THE SECURITIES MARKETS

The Division of Market Regulation, together with regional office examination staff, oversees the operations of the nation's securities markets and market professionals. In fiscal year 1990, over 10,000 broker-dealers, 9 active securities exchanges, the over-the-counter (OTC) markets, and 15 clearing agencies were subject to the Commission's oversight.

Key 1990 Results

[table omitted]

In fiscal year 1990, the Commission continued to direct its attention towards: market reforms, including a major legislative program, that address problems resulting from the 1987 market break[90] and subsequent episodes of extreme market volatility; enhancement of regulation and oversight of broker-dealers to combat “penny-stock” fraud and to maintain the financial integrity of firms servicing public investors; internationalization of markets, a trend which has had a marked impact on virtually all of the Commission's market supervision activities; and assuring that other fundamental changes in the markets, *e.g.,* in terms of the growth in size and diversity of firms and products, proceed in a sound and orderly way and without unnecessary regulatory restraints on industry innovation or competition.

Securities Markets, Facilities, and Trading

Market Reform Initiatives

The nation's securities markets continued to experience periodic episodes of large price and volume volatility. These events demonstrated that the episodes of intense volatility encountered during and shortly after the October 1987 market break were not isolated occurrences. As a result, the Commission continued to pursue many of the market reform initiatives begun in 1988 in order to enhance the stability and integrity of the nation's securities markets.

On September 25, 1990, Congress enacted the Market Reform Act of 1990 to enhance the efficiency and fairness of the United States capital markets and to help avoid precipitous market declines.[91] The legislation, largely proposed by the Commission in 1988, covers several problem areas identified by the October 1987 market break. First, it authorizes the Commission to establish rules regarding information reporting by broker-dealer holding companies for purposes of risk assessment. Second, it enables the Commission to promulgate rules providing for large trader reporting. Third, it authorizes the Commission to facilitate development of coordinated clearance and settlement systems. Fourth, it empowers the Commission to promulgate uniform rules, preempting state law, concerning the transfer and pledge of securities to facilitate the efficient and safe operation of the national clearance and settlement system. Fifth, it provides the Commission, subject to disapproval by the President, with the emergency authority to halt trading in securities markets. Sixth, it grants the Commission authority to limit trading practices that contribute significantly to extraordinary volatility.

The Division of Market Regulation prepared a report on the trading and price volatility experienced on October 13 and 16, 1989.[92] The report, which is summarized below, analyzed the impact of program trading and related stock index futures and options strategies on market volatility during this period.

In addition, the Commission approved rule changes to continue the coordinated circuit breaker programs of the American Stock Exchange (Amex), Boston Stock Exchange (BSE), Chicago Board Options Exchange (CBOE), Cincinnati Stock Exchange (CSE), Midwest Stock Exchange (MSE), National Association of Securities Dealers, Inc. (NASD), New York Stock Exchange (NYSE), Philadelphia Stock Exchange (Phlx), and Pacific Stock Exchange (PSE).[93] These rule changes provide for a one-hour temporary trading halt if the Dow Jones Industrial Average (DJIA) falls more than 250 points on a single day, and two hours if more than 400 points. The Commodity Futures Trading Commission (CFTC) had approved analogous rule changes submitted by futures exchanges with respect to halts in the trading of stock index futures and options on those futures. In addition, the Commission approved a NYSE proposal to require that index arbitrage equity trades only be effected on stabilizing ticks when the DJIA moves 50 points from the previous day's close.

The Commission continued its discussions with the Group of Thirty subsequent to the Group's report on global clearance and settlement systems. The United States Working Committee of the Group of Thirty has been studying ways to implement recommendations concerning same-day funds settlement of securities transactions and reducing the settlement period from five to three days after the trade (from T+5 to T+3). The Commission staff has contributed to the efforts of the United States Working Committee. The Commission staff also consulted extensively with an American Bar Association (ABA) committee examining possible federal and state legal impediments to efficient and safe clearance and settlement of securities transactions.

Finally, the Commission issued its Automation Review Policy[94] to request that the exchanges and the NASD establish comprehensive

systems capacity, security, and contingency planning programs, and obtain independent annual reviews of these programs. The Office of Automation and International Markets in the Division of Market Regulation was created to monitor the SROs' progress in this area.

The National Market System

The Commission approved the NASD's electronic Bulletin Board Service for a one-year pilot program. The bulletin board is designed to disseminate, on behalf of NASD members acting as market makers in OTC securities that are neither listed on a national securities exchange nor included in the NASDAQ system, quotations and unpriced indications of interest in those securities.[95] As of September 1990, the service included 216 registered market makers with 10,653 positions in 4,352 securities.

The NASD's PORTAL system established a new marketplace for secondary trading of unregistered securities in transactions exempt from the registration requirements of the Securities Act of 1933 (Securities Act), pursuant to Rule 144A.[96] The PORTAL market is comprised of computer and communication facilities that, in addition to supporting primary placements and resale trading, provide for the clearance and settlement of domestic and foreign debt and equity securities through designated PORTAL clearing and depository organizations. PORTAL began operation on June 15, 1990 with 20 United States and European securities firms as subscribers and four financial institutions approved as qualified institutional buyers. As of September 19, 1990, there were 14 issues listed on PORTAL, 23 approved dealers, and 9 approved brokers. NASD Market Services, Inc., a NASD subsidiary involved in the operation of the PORTAL system, was granted a temporary exemption from registration as a securities information processor under Section 11A of the Securities Exchange Act of 1934 (Exchange Act).[97]

In June 1990, the Commission approved a joint industry plan filed with the Commission by the NASD and the American, Boston, Midwest, and Philadelphia Stock Exchanges that governs the collection, consolidation, and dissemination of quotation and transaction information for NASDAQ/National Market System (NASDAQ/NMS) securities listed or traded on an exchange pursuant to a grant of unlisted trading privileges (OTC/UTP).[98] The Commission had conditioned the granting of OTC/UTP to exchanges on the submission and approval of the Joint Industry Plan.

Following the Commission's adoption of Rule 19c-5 eliminating barriers to the competitive trading of options on equity securities in multiple markets,[99] the Commission staff has been working with the exchanges that trade options in their efforts to develop an options market linkage to accommodate multiple trading of options. Several exchange working groups have met to proceed with necessary design and programming work to implement the linkage. One significant area of disagreement among the exchanges remains: the Phlx continues to urge the Commission to require that order execution be based on time priority, so that each order is directed to the exchange that is first to display the best bid or offer, rather than permitting the exchanges that first receive the order to match that price. On October 17, 1990, Chairman Breeden requested that each exchange extend its earlier commitment voluntarily to refrain from listing any options that were traded on another options exchange before January 22, 1990 until February 1, 1991.[100] The exchanges submitted a joint industry plan for an options market linkage on December 4, 1990.

National System for Clearance and Settlement

The Commission continued to work with clearing agencies, banks, broker-dealers, and other federal regulators to enhance all components of the National System for Clearance and Settlement (National System). For example, the Commission approved: (1) rule changes that fully implemented next-day comparison of exchange and OTC corporate securities trades[101] and automated the resolution of uncompared trades;[102] (2) clearing agency proposals expanding Securities Clearance Group (SCG) membership to include Boston Stock Exchange Clearing Corporation, Government Securities Clearing Corporation (GSCC), and MBS Clearing Corporation (MBSCC); (3) a proposal by the Depository Trust Company (DTC) to add certain commercial paper transactions to its same-day funds settlement system, on a temporary basis, for a period of 18 months;[103] (4) clearing agency proposals that enhanced safe and efficient processing of transactions in United States government and agency securities;[104] and (5) proposals by the International Securities Clearing Corporation and DTC to provide clearing and depository functions for the PORTAL marketplace.[105]

The Commission also extended the approval of the Participants Trust Company (PTC) and MBSCC for another year.[106] PTC provides depository services, and MBSCC provides trade comparison and netting services for mortgage-backed securities.

Internationalization

During fiscal year 1990, the Commission continued its oversight of international linkages between markets and other securities related organizations. For example, in connection with the approval of the PORTAL system, discussed above, the International Securities Clearing Corporation (ISCC) received approval of a rule filing that would enable the ISCC to be a PORTAL clearing organization.[107] As such, the ISCC's responsibilities are to act as a data communications

vehicle for PORTAL participants, the NASD, PORTAL depository organizations, and the Institutional Delivery System operated by the DTC. The ISCC also received a no-action letter concerning a link between the ISCC and CEDEL, an international clearance and settlement organization headquartered in Luxembourg, that would establish CEDEL as a PORTAL depository organization.[108] As such, CEDEL will offer depository services for foreign securities traded in the PORTAL system. The ISCC's various functions are intended to enable settlements of PORTAL transactions to take place safely, efficiently, and accurately using existing automated systems for clearance and settlement. In connection with the PORTAL link between the ISCC and CEDEL, the Commission and the Luxembourg Monetary Institute, CEDEL's regulator, entered into a Memorandum of Understanding concerning the sharing of information about transactions taking place through the PORTAL accounts.[109]

The Commission also authorized the extension for a six-month period of the NASD's operation of its pilot program with the Stock Exchange of Singapore Limited (SES). The pilot program currently consists of an interchange of closing prices and volume data on 27 NASDAQ securities that also are traded through the SES's facilities. The end-of-day information being exchanged under this program primarily assists the establishment of opening prices for the folio each business day. The Commission's approval of the extension permits continuation of the pilot through May 12, 1991.[110]

Several significant NYSE rule changes with an international effect were approved by the Commission in fiscal year 1990. For example, the Commission approved:

- a NYSE rule that Waived certain listing standards for non-United States companies when the foreign company's procedure is not prohibited by the laws of its home country;[111]

• a NYSE rule that established a modified Series 7 examination for United Kingdom representatives registered with The Securities Association, a United Kingdom self-regulatory organization;[112] and

• a NYSE rule that codified general language that authorizes the exchange to enter into bilateral information-sharing agreements for regulatory purposes with domestic and foreign exchanges and associations.[113]

The Commission staff issued a no-action letter to ISCC concerning a clearance and settlement link with the International Stock Exchange of the United Kingdom and the Republic of Ireland, Ltd. The letter covers transactions of United States and United Kingdom brokers that are being settled in the United Kingdom through the facilities of the exchange and transactions being settled in the United States at the National Securities Clearing Corporation (NSCC) and DTC, through ISCC-sponsored accounts.[114] The Commission staff also issued a no-action letter to NSCC concerning its link with the Canadian Depository for Securities (CDS) that expands NSCC's existing link with CDS to include a direct input capability for trades on the Toronto Stock Exchange in NSCC-eligible issues between CDS participants and NSCC members.[115]

Several new internationally based derivative product proposals were approved by the Commission during the fiscal year. First, the Commission approved several exchanges' proposals to trade index warrants. Index warrants are direct obligations of their issuer subject to cash settlement during their term. The holder of an index warrant structured as a “put” option receives payment in United States dollars to the extent that the index has declined below a pre-stated cash-settlement value; the holder of a warrant structured as a “call” option receives payment in United States dollars to the extent that the index

has increased above the pre-stated cash-settlement value. The Commission approved several important requirements attendant to the listing and trading of index warrants, including, among other things, that: (1) the warrant issuer must conform to the exchange's listing guidelines; (2) the exchange's options suitability standards apply to recommendations regarding index warrants; and (3) each exchange must have an adequate mechanism to surveil trading in the warrant and the index's component stocks. In this connection, the Commission approved a proposal submitted by the Amex to trade warrants based on the Nikkei Stock Average (Nikkei), an internationally recognized, price-weighted index consisting of 225 actively-traded stocks on the Tokyo Stock Exchange (TSE).[116] The Commission also approved proposals by the Amex, the NYSE, and the PSE to trade warrants based on the Financial Times-Stock Exchange 100 Index (FT-SE 100), an internationally recognized capitalization-weighted stock index based on the prices of 100 of the most highly capitalized British stocks traded on the International Stock Exchange of the United Kingdom and the Republic of Ireland (ISE).[117]

Further, the Commission received several proposals to list and trade CAC-40 Index warrants.[118] First, the exchanges proposed to list index warrants based on the CAC-40, an internationally recognized, capitalization-weighted index consisting of 40 leading stocks listed and traded on the Paris Bourse and calculated by the Societe des Bourses Francaises (SBF). The SBF operates under the direction of the Council des Bourses de Valeurs or Stock Exchange Council, a regulatory organization similar to a self-regulatory organization (SRO) in the United States. Among other things, the SBF implements decisions made by the Stock Exchange Council, monitors and supervises the French stock market, and provides investors with comprehensive information on market activities. To facilitate the surveillance of this product, on September 18, 1990 the Commission

and the Commission des Operations de Bourse (COB) exchanged letters that provide a mechanism for the exchange of information, including customer information, for transactions involving a derivative security or the stocks underlying such security when a derivative security is traded in United States or French markets and the underlying securities are traded in the other country's markets.[119] The COB is an autonomous administrative body patterned after the Commission. It functions as the French market regulator with authority to undertake investigations, notify French judicial authorities, and levy fines. These letters supplement surveillance sharing agreements between the exchanges and SBF. The exchange proposals were under review at year-end.

Second, the Commission approved a proposal submitted by the Amex to list and trade standardized European-style options based on the Japan Index (Index), a broad-based, price-weigh ted index developed by the Amex and comprised of 210 Japanese stocks traded on the TSE.[120] Although the Index is comprised of Japanese stocks, it is valued in United States dollars. Options on the Index are governed by Amex rules applicable to the trading of index options, including rules relating to disclosure, account approval and suitability, position and exercise limits, margin, and trading halts and suspensions. The Amex has developed a special surveillance program for the options.

Third, the Division of Market Regulation issued a letter to the CFTC indicating that the division would not object if the CFTC staff took a no-action position to allow the offer and sale to United States citizens of futures contracts overlying the FT-SE 100.[121]

In addition to specific regulatory actions, the staff participated in several international securities working groups under the auspices of the Technical Committee of the International Organization of

Securities Commissions (IOSCO). Those working groups and their recent activities are listed below.

The *Working Group on Principles of Ethical Conduct* issued a "Report on International Conduct of Business Principles," which identified seven non-exclusive conduct of business principles to protect customer interests and market integrity. This report was approved at the IOSCO meeting in November.

The *Working Group on Clearance and Settlement* issued a report that discussed recommendations to improve the cross-border settlement process and long-term goals for individual countries as well as for clearance and settlement linkages. This report was approved at the last meeting of the Technical Committee in June 1990.

The *Working Group on Futures Markets* presented a "Report on Screen-Based Trading Systems for Derivative Products" as well as "Suggested Principles for the Oversight of Screen-Based Trading Systems," which the Technical Committee released at the IOSCO meeting in November 1990. This report proposed several non-exclusive principles related to common regulatory concerns affecting the oversight of screen-based trading systems, including access to such systems.

The *Working Group on Capital Adequacy* prepared four papers for approval by the Technical Committee with respect to non-bank securities firms on: (1) comparison of equity position risk requirements and scope for harmonization; (2) comparison of debt position risk requirements; (3) base requirement and the minimum requirement for capital; and (4) the definition of capital. The submission of the first three papers was approved at the Technical Committee meeting in June.

The Commission received a significant number of requests from foreign government officials for technical assistance on securities matters. To assist the Commission in responding to these requests, on March 7, 1990 Chairman Breeden announced the Commission's intent to form the Emerging Markets Advisory Committee (EMAC). EMAC's purpose is to advise the Commission on how the Commission can best assist the development of securities markets in Eastern Europe and elsewhere. The first EMAC meeting was held on June 12, 1990. At this meeting, EMAC participants agreed to form working groups to gather information and formulate approaches to the advisory group's mission.

Options and Other Derivative Products

During fiscal year 1990, the Commission approved several rule changes intended to address market volatility concerns. First, the Commission approved on a one-year pilot basis a proposal filed by the NYSE to place conditions on index arbitrage orders to buy or sell component stocks of the Standard & Poor's 500 Stock Price Index (S&P 500 Index) when the DJIA advances or declines by 50 points or more from its previous day's closing value (80A Conditions).[122] Specifically, when the DJIA advances 50 points, index arbitrage orders to buy or sell component stocks of the S&P 500 Index must be entered with a “buy minus” instruction. Conversely, when the DJIA declines 50 points, such orders must be entered with a “sell plus” instruction. Once activated, the conditions remain in effect for the remainder of the trading day unless the DJIA moves to within 25 points of its previous day's close, when the restrictions are removed. They are reinstated if the DJIA again moves 50 points or more away from the previous day's close. In addition, the Commission approved a NYSE proposal to exempt index arbitrage market-on-close orders from the 80A Conditions on expiration Fridays in order to facilitate the

liquidation of stock positions previously established in connection with derivative index products.[123]

Second, the Commission approved rule changes submitted by the Amex, MSE, NYSE, and the Phlx to extend the effectiveness of their circuit breaker procedures.[124] The BSE, CBOE, CSE, and PSE circuit breaker procedures previously had been approved through October 1991. In general, the circuit breaker rules provide that trading in all markets will halt for one hour if the DJIA declines 250 points or more from its previous day's closing level and, thereafter, trading will halt for an additional two hours if the DJIA declines 400 points from the previous day's close.

Third, the Commission approved a proposal by the NYSE to modify its Individual Investor Express Delivery Service (IIEDS) to provide that market orders of individual investors with up to 2,099 shares will have priority delivery to specialists' posts through the exchange's Super Dot system ahead of all other orders at all times.[125] Prior to the rule change, IIEDS was available only on days when the DJIA moved 25 points up or down from the previous day's close.

In addition, the Commission approved several rule changes relating to automation of the options exchanges. First, the Commission approved a PSE proposal to implement the Pacific Options Exchange Trading System (POETS), a completely automated trading system comprised of (1) an options order routing system (ORS) that allows the PSE to accept, edit, and route market and limit orders electronically submitted to the PSE; (2) an automatic and semi-automatic execution system (Auto-Ex); (3) an on-line limit order book system (Auto-Book) that allows the PSE to enter, update, inquire, delete, cancel, and execute public customer orders on the limit order book; and (4) an automatic quote update system (Auto-Quote) that

allows quotes to be generated systematically, using programmed theoretical models.[126]

Second, the Commission approved a proposal submitted by the Phlx to permit the use of the Automated Options Market (AUTOM) electronic order delivery system for eligible day limit orders and to expand AUTOM, on a pilot basis, to include an automatic execution feature for 12 Phlx equity options and any multiply-traded option.[127] The automatic execution feature of AUTOM is available only to single customer market and marketable limit orders of up to 10 contracts relating to near-term options series that are at-the-money and just out-of-the-money. Firm and market maker orders are not eligible for automatic execution through AUTOM. Once the automation execution feature is engaged, eligible orders are priced and executed automatically at the displayed bid or offer, and the execution is reported automatically to the Options Price Reporting Authority for public dissemination.

Third, the Commission approved on a pilot basis a CBOE proposal to amend the eligibility standards for individuals and groups that participate in the CBOE's Retail Automatic Execution System (RAES) for options on the Standard & Poor's 100 Index (OEX).[128] RAES is an electronic order routing and execution system for small options orders. The CBOE limits RAES participation in OEX options to OEX and Standard & Poor's 500 Index (SPX or NSX) market makers that meet certain trading requirements; restricts the size of, and imposes obligations upon, group accounts operating on RAES; and includes provisions designed to ensure adequate RAES-participation in OEX options. The Commission also approved CBOE proposals to make the eligibility requirements for market makers participating in RAES, SPX/ NSX, and equity options permanent.[129] Finally, the Commission approved a CBOE proposal to increase the maximum size of RAES-eligible orders for equity options from 10 to 20 contracts.[130]

During fiscal year 1990, the Commission took steps to implement Rule 19c-5, which authorizes the multiple trading of standardized options. The rule took effect as to all newly-listed options on January 21, 1990. As already noted, the Commission requested that the exchanges delay the commencement of multiple trading in options until February 1991 while they continue their work to develop a joint plan for a market linkage facility.

The Commission approved several other important rule changes by the options exchanges. First, the Commission approved a one-year pilot program proposed by the PSE to require PSE trading crowds to provide a depth of 10 contracts for all non-broker-dealer customer orders in options series included in the pilot program (Ten-Up requirement).[131] To satisfy the Ten-Up requirement, the trading crowd must fill the customer orders at the disseminated market quote at the time the orders are announced or displayed at a trading post.

Second, the Commission approved a PSE proposal to create a Lead Market Maker (LMM) program designed to supplement the standard PSE options trading pit and thereby enhance the exchange's options market-making quality.[132] Specifically, a LMM, in addition to fulfilling general market maker obligations, must, among other things, be present throughout every business day, assure that disseminated market quotations are accurate, assure that each disseminated market quotation shall be honored for a minimum of 10 contracts, and participate at all times in any automated execution system that is operating. In exchange for assuming additional responsibilities in their appointed options classes, the LMMs are allocated a 50 percent participation in transactions occurring in their appointed issues.[133]

Third, in order to facilitate the continued trading of options listed on the PSE after mechanical disruptions to the PSE options floor caused

by the October 17, 1989 earthquake in northern California, the Commission approved proposals submitted by the Amex, CBOE, NYSE, and Phlx to allow for the trading of PSE options on their respective exchanges for two days, and a proposal by the PSE to accommodate this transfer.[134]

Fourth, the Commission approved proposals submitted by the Amex, CBOE, NYSE, and Phlx that provide hedge exemptions from options position and/or exercise limits. Specifically, the Commission approved (1) six-month extensions of pilot programs previously adopted by the Amex and the CBOE that exempt hedged equity options positions from position limits;[135] (2) a one-year pilot program proposed by the Phlx to allow public customers to apply for a hedge exemption from Utility Index Option position limits;[136] and (3) on a pilot basis, a NYSE proposal to exempt fully hedged equity options positions from position and exercise limits and a proposal to allow public customers to apply for a hedge exemption from broad-based index option position limits.[137] The Commission also approved a NYSE proposal to modify the position and exercise limits applicable to options on its broad-based stock index, the NYSE Composite Index.[138] The NYSE modified its rules to express the exchange's position and exercise limits in terms of the numbers of contracts that a party may hold rather than in the dollar value of the contracts. Specifically, the NYSE (1) set the aggregate position limit at 45,000 contracts on the same side of the market, with no more than 25,000 contracts in the nearest term series, and (2) established an exercise limit of 25,000 contracts (the same limit as the nearest-term series position limit).

Regulation of Brokers, Dealers, Municipal Securities Dealers, and Transfer Agents

Broker-Dealer Examination Program

The broker-dealer examination program's primary purpose is to provide oversight of the SROs responsible for the routine examination of those broker-dealers conducting a public securities business. This oversight evaluation process is accomplished primarily through the examination of broker-dealer firms recently examined by a SRO. Additionally, cause examinations are conducted when the Commission becomes aware of circumstances that warrant direct Commission inquiry rather than a SRO review. In fiscal year 1990, 371 oversight examinations and 176 cause examinations were completed, 43 more oversight and 28 more cause examinations than were completed in fiscal year 1989.

The Commission continued to place a high priority on examinations of penny stock broker-dealers. As a result of this special emphasis, nearly one-third of the 547 examinations completed during fiscal year 1990 were of broker-dealers engaged in the penny stock business. The findings of these examinations have justified the special emphasis placed on these firms. In this regard, the findings of 55 (33 percent) of the 165 completed penny stock examinations were referred for enforcement consideration. Additionally, referrals for enforcement consideration were made in 26 (7 percent) of the remaining 382 completed examinations.

The most significant accomplishment in the broker-dealer examination program occurred in March and April 1990. The Commission staff, along with the NASD and Florida's Office of the Comptroller, Division of Securities, conducted an examination sweep of 188 offices (including both main and branch offices) of 144 different penny stock firms primarily to assess the industry's compliance with new Rule 15c2-6 (the penny stock “cold call” rule) under the Exchange Act. Rule 15c2-6 imposes specific sales practice requirements on broker-dealers who recommend and sell low-priced non-NASDAQ OTC securities to investors who are not established

customers of the broker-dealer. The Commission's examinations conducted as part of the sweep resulted in 12 referrals for enforcement consideration and five referrals to the NASD for its consideration. In all, 43 (23 percent) of these examinations revealed violations of the rule sufficiently serious to result in recommendations for possible investigation to the appropriate enforcement staff of the Commission, NASD, or Florida. As this data suggests, however, the examination sweep did disclose that there was substantial compliance with the new rules by a large majority of firms examined.

A review of broker-dealers engaged solely in a government securities business was undertaken during fiscal year 1990. An examination of Stotler & Company, a registered government securities dealer, resulted in revocation of the firm's registration on findings of net capital deficiencies ranging between $11 and $12 million, and failure to become a member of a registered securities association, establish and maintain current records, and prepare and file financial reports.

Cold Calling Rule Interpretations

The division worked with the NASD in developing a question-and-answer “NASD Notice to Members” on Rule 15c2-6 under the Exchange Act, the Commission's “cold calling rule.” The question-and-answer release covered a number of frequently asked questions under the rule, which imposes suitability and customer agreement requirements on broker-dealers recommending certain low priced stocks to new customers. The division also worked with the NASD to prepare sample customer forms for satisfying the rule's requirements. These forms were published in a subsequent NASD Notice to Members.

Commission Dollar Practices

Section 28(e) of the Exchange Act provides a safe harbor for the use by money managers of commission dollars of their advised accounts to obtain investment research and related brokerage services.[139] On July 25, 1990, the Commission authorized the Division of Market Regulation to respond to a request of the Department of Labor for an interpretation of the safe harbor as applied to these “soft dollar practices” involving employee benefit plans covered by the Employee Retirement Income Security Act of 1974.[140] The division interpreted the scope of Section 28(e) as not extending to transactions by a money manager effected with a broker-dealer on a principal (including riskless principal) basis or to futures transactions.[141] The division indicated that the statutory exemption should not be expanded by interpretation to encompass an area not clearly envisioned by Congress.

Foreign Broker-Dealers

In a series of no-action letters, the division adopted a flexible approach to recent developments in the international capital markets while satisfying investor protection and enforcement concerns. The division issued a no-action letter to the International Stock Exchange of the United Kingdom and the Republic of Ireland, Ltd. (ISE)[142] permitting the ISE to establish a representative office in New York City to familiarize certain broker-dealers and large financial institutions in the United States with standardized United Kingdom equity and index options traded on the ISE's London Traded Options Market (LTOM), without the ISE or LTOM registering as an exchange under Section 6,[143] LTOM members registering as broker-dealers under Section 15(b),[144] or the London Options Clearing House registering as a clearing agency under Section 17A of the Exchange Act.[145] The ISE agreed to adopt rules requiring LTOM members to assure that United States customers (a) are eligible broker-dealers or institutions under Rule 144A and Regulation *S* under the Securities

Act; (b) have actual experience in the United States options markets; and (c) have received a LTOM disclosure document and an options disclosure document, as required by Rule 9b-1 under the Exchange Act.

The division also took a no-action position[146] with respect to the treatment of unregistered firms that are members of the Association of International Bond Dealers (AIBD) as broker-dealers, and not as "customers," for purposes of Rule 10b-10 under the Exchange Act, thereby permitting registered broker-dealers that are AIBD members to use the AIBD's confirmation procedures, instead of those imposed by Rule 10b-10, solely with respect to transactions with other AIBD members. In another interpretation of Rule 10b-10, the division took the position that foreign banks acting as securities professionals also are not "customers."[147]

The division extended indefinitely its temporary no-action position regarding application of the broker-dealer registration requirements of Section 15(a) of the Exchange Act to TOPIC Services, Inc. (TOPIC), a provider of quotation information, the ISE, and market makers in securities listed in the ISE's Stock Exchange Automated Quotations system (SEAQ) that transmits quotations to subscribers of TOPIC terminals in the United States, provided there are no other substantial United States contacts.[148] In another interpretive letter, the division stated that foreign market makers participating in a pilot program involving the exchange and dissemination of quotations in the NASDAQ and SEAQ systems are exempt from the application of Section 15(a) under Rule 15a-6, because the only United States recipients of quotations would be qualifying NASDAQ registered market makers.[149] The division also extended indefinitely its no-action position under Section 15(a) regarding the participation of the Stock Exchange of Singapore and its members in a pilot program with the

NASD, consisting of a daily interchange of static quotes compiled at the close of each market day.[150]

International Offerings

During fiscal year 1990, the Commission took several actions with respect to the application of Rules 10b-6, 10b-7, 10b-8, and 10b-13 under the Exchange Act to transactions involving concurrent United States and foreign securities distributions, rights offerings, and tender offers. Rule 10b-6 proscribes certain conduct by persons participating in a distribution to prevent such persons from artificially conditioning the market for a security to facilitate the distribution. Rule 10b-7 governs market stabilization activities during an offering. Rule 10b-8 governs the market activities of participants in a rights offering. Rule 10b-13 prohibits purchases otherwise than pursuant to a tender offer or exchange offer from the time such offer is publicly announced until the offer expires. The Commission granted relief under these anti-manipulation rules for multinational offerings that permitted non-United States persons to continue certain customary market activities in foreign jurisdictions during multinational transactions, subject to certain conditions designed to prevent a manipulative impact on the United States market.

For example, an exemption was granted to permit a United Kingdom market maker affiliate of the dealer managers of concurrent United States and United Kingdom tender offers to continue passive market making activities during the tender offers.[151] Similarly, a United Kingdom market maker affiliated with a distribution participant was permitted to continue its market making activity during a concurrent United Kingdom and United States rights offering.[152] In connection with sales in the United States of foreign securities pursuant to Securities Act Rule 144A, exemptions were granted to Swedish,[153]

Finnish,[154] and French[155] issuers to permit the broker-dealers to engage in passive market making during the distribution.

In October 1990, the Commission reproposed the Multijurisdictional Disclosure System, which included proposed no-action positions under Rules 10b-6 and 10b-13 to permit participants in certain cross-border exchange and tender offers to engage in certain activities permitted under Canadian law.[156]

Short Sales

In April 1990, the Commission published a staff interpretation under Exchange Act Rule 10a-1, the short sale rule, clarifying an earlier staff letter.[157] The interpretation permits market participants to liquidate existing index arbitrage positions consisting of long baskets of stock and short index futures or options without aggregating long stock positions with short positions in those stocks in certain other proprietary accounts, provided that those short positions are fully hedged. The release emphasized, among other things, that the interpretation is limited to the liquidation of index arbitrage positions established in compliance with Rules 3b-3 and 10a-1 under the Exchange Act.

Report to Congress on Proposed Amendment to Section 11(a) of the Exchange Act

Section 11 (a) of the Exchange Act provides generally that exchange members and their associated persons are prohibited from effecting securities transactions on the floor of an exchange of which they are members for their own accounts, accounts of their associated persons, and accounts over which the members or their associated persons exercise investment discretion. The Commission transmitted to Congress a report of the Division of Market Regulation[158] in

response to a congressional request for the Commission's view on a legislative proposal by Fidelity Management & Research Company (Fidelity) to amend Section 11(a).[159] The Commission concurred in the conclusion of the division's report. Fidelity proposed excluding from the prohibitions of Section 11 (a) the execution by broker-dealers of trades for accounts for which exchange members or their associated persons exercise investment discretion.

In the report, the division traced the developments in the industry that led to the adoption of Section 11(a), legislation reflecting Congress's concern with market dislocations, trading advantages, and perceived conflicts of interest arising from the combination of money management and brokerage functions. The division concluded that elimination of the managed account provision of Section 11(a) would reduce costs for affiliated brokers executing orders for managed accounts, without significantly changing the extent to which money managers would use affiliated brokers. However, the division concluded that the compensation authorization and annual disclosure requirements of Rule 11a2-2(T) cause account managers to focus on possible conflicts of interest. The division therefore recommended the elimination of the managed account provision of Section 11(a), provided that the legislation

gives the Commission rulemaking authority to retain the managed account authorization and compensation disclosure requirements.

Financial Responsibility Rules

On August 15, 1990, the Commission proposed for comment amendments to Rule 15c3-1 under the Exchange Act concerning the withdrawal of capital from a broker or dealer.[160] The proposed amendments were a response, in part, to the bankruptcies of the Drexel Burnham Lambert Group, Inc. and its registered broker-dealer

subsidiary, Drexel Burnham Lambert, Inc., and are designed to address the situation where a parent or affiliate of a broker-dealer withdraws capital from the broker-dealer. The amendments are intended to improve the Commission's ability to protect the customers and creditors of a broker or dealer in those circumstances where a financial problem in a holding company or other affiliate leads to withdrawal of capital from the broker or dealer. The amendments would create a new early warning level under the net capital rule that would prohibit brokers and dealers from withdrawing capital at an earlier stage than is now permitted. Additionally, the proposal would require brokers and dealers to notify the Commission in advance of certain significant withdrawals of capital. Finally, the amendments would establish procedures under which the Commission may, by order, halt the withdrawal of capital from a broker or dealer when the Commission believes that the withdrawal may be detrimental to the financial integrity of the firm.

On January 31, 1990, the division issued a no-action letter to the NYSE and the NASD in which it allowed brokers and dealers to treat certain options contracts not listed on an exchange as listed options contracts for the purposes of the net capital rule.[161] The letter specifies the circumstances under which brokers and dealers may take advantage of the more beneficial treatment accorded listed options contracts under Rule 15c3-1.

On August 6, 1990, the division issued a no-action letter to the Securities Industry Association[162] stating that, for purposes of complying with the requirements of Rule 15c3-3a, the Formula for Determination of Reserve Requirement for Brokers and Dealers Under Rule 15c3-3 (Reserve Formula), and the quarterly securities count specified in Rule 17a-13, brokers and dealers may treat the actual settlement date of certain foreign issued and settled securities as the settlement date for purposes of these provisions. If the

settlement cycle is on a “seller's option basis,” the settlement date must be a date no more than 30 days from the trade date. The letter also permits brokers and dealers to include as debit items in their Reserve Formula computations foreign issued and settled failed-to-deliver securities contracts outstanding less than 30 days past the customary settlement date that allocate to either failed-to-receive contracts or other includable contracts. The letter sets forth certain conditions that must be met for brokers and dealers to operate under its provisions.

Lost and Stolen Securities

Rule 17f-1 under the Exchange Act sets forth participation, reporting, and inquiry requirements for the Lost and Stolen Securities Program (Program). As of September 31, 1990,23,028 institutions were registered in the Program. Statistics for calendar year 1989 (the most recent year available) reflect the Program's continuing effectiveness. During that year, registered institutions reported as lost and stolen, missing or counterfeit 866,306 certificates valued at $2,136,398,027. Those institutions also reported the recovery of 123,599 certificates valued at $589,785,817. At the end of 1989, the aggregate value of securities contained in the Program's database was $16,625,727,986. Program participants *(e.g.,* banks and broker-dealers) made inquiries concerning 2,861,196 certificates. Inquiries concerning 5,298 certificates valued at $10,681,680 matched reports of lost, stolen or missing securities on file in the database.

Oversight of Self-Regulatory Organizations

National Securities Exchanges

As of September 30, 1990, there were nine active securities exchanges registered with the Commission as national securities

exchanges: the Amex, BSE, CBOE, CSE, MSB, NYSE, Phlx, PSE, and SSE. During fiscal year 1990, the Commission granted exchange applications to delist 106 debt and equity issues and nine options issues, and granted applications by issuers requesting withdrawal from listing and registration for 33 issues. In addition, the Commission granted 843 exchange applications for unlisted trading privileges.

The exchanges submitted 107 proposed rule changes to the Commission during fiscal year 1990. Many of these filings are described in the section above entitled “Securities Markets, Facilities, and Trading.” Among the most notable other rule changes that were granted Commission approval were proposals by the NYSE and CBOE to trade standardized baskets of 500 stocks at an aggregate price in a single execution.[163] Relatedly, the Commission also approved a MSE proposal to establish a secondary trading session that would operate from 4:30 p.m. until 6:00 p.m. EST, for the execution of transactions in portfolios of securities through its automated Portfolio Trading System.[164]

The Commission also approved various proposed rule changes relating to the evaluation of exchange specialists. The most significant of these proposals included the Amex's revision of its specialist performance, allocation, and reallocation procedures, including revisions of its specialist unit evaluation questionnaire;[165] a MSE proposal to revise its Co-Specialist Evaluation Questionnaire, which is completed periodically by floor brokers in order to assess the performance of MSE co-specialists;[166] and NYSE proposals to revise and codify its procedures governing the allocation of equity securities to specialist units,[167] and to modify its Specialist Performance Evaluation Questionnaire in order to establish a new rating scale and a relative scoring methodology.[168]

With regard to the listing of securities on the exchanges, the Commission approved proposals submitted by the Amex and NYSE relating to listing guidelines for “hybrid” securities possessing both debt, equity, and/or derivative characteristics;[169] proposals by the NYSE and MSE to list and trade contingent value rights;[170] and a proposal by the CSE to upgrade its listing standards for common stock, preferred stock, warrants, and bonds.[171] Furthermore, the Commission partially approved a NYSE proposal to adopt a voting rights listing standard that is designed to guard against the potential disenfranchisement of existing common stock shareholders.[172] This voting rights listing standard used the language and concepts of the Commission's Rule 19c-4, which was ordered vacated by the D.C. Circuit Court during fiscal year 1990.[173]

In addition, the Commission approved proposed rule changes submitted by the MSB and PSE to allow such exchanges to exempt their governors from monetary damages for breach of fiduciary duty to the exchange, limiting such exemption to those situations not involving a violation of the federal securities laws.[174] The Commission also approved proposals by the MSE and PSE to reduce from 30 seconds to 15 seconds the exposure period for orders entered through their respective automated small order routing and execution systems,[175] and, on a six-month pilot basis, a MSE proposal whereby the guaranteed execution price of small agency market orders received over the MSE Automatic Execution System are improved automatically from the consolidated best bid or offer according to predefined criteria.[176]

An Amex proposal to adopt a new disciplinary fine system for general rule violations and to amend the Amex's minor rule violation enforcement and reporting plan was approved by the Commission.[177] The Commission also approved the addition of 19 rules to the list of NYSE rules that are covered by its minor rule violation plan.[178] In

addition, the threshold for member reporting of certain judgments, settlements, or claims under NYSE Rule 351 was increased from $5,000 to $15,000 for associated individuals and from $5,000 to $25,000 for member organizations.[179]

During fiscal year 1990, the Commission approved a NYSE proposal that, for a one-year pilot period, would provide market-on-close (MOC) orders with the closing price “whenever practicable,” and to allow for the execution of matched MOC orders entered by the same firm.[180] The Commission also approved a modified version of the General Securities Representative (Series 7) Examination developed by the NYSE.[181] By obtaining a passing score on this modified examination, a qualified registered representative can satisfy the requirements to become a registered representative with a NYSE member organization.

The PSE's proposal to establish an electronic access membership, the Automated System Access Privilege (ASAP), was approved by the Commission during fiscal year 1990.[182] The ASAP system allows certain qualified broker-dealers who are not regular PSE members to obtain access to the PSE's automated trading systems. In addition, a CSE proposal to increase its minimum net capital requirement for Designated Dealers to $100,000 was approved by the Commission.[183]

The Commission approved two significant rule changes submitted by the NYSE that revised its odd-lot pricing procedures. First, the Commission approved the NYSE's proposal to establish the use of a “Best Pricing Quote” in order to provide odd-lot customers with the best prices available in the national market system.[184] The Commission also approved the NYSE's proposal to establish a four-month, three-firm pilot program that eliminates all odd-lot differentials and extends the NYSE's current “no commission policy” to provide

that no floor brokerage charges shall be imposed on systematized odd-lot orders.[185]

Finally, several proposals submitted by the BSE to amend its Constitution were approved by the Commission.[186] These proposals included, among other things, changes in the composition of the BSE's Board of Governors, modification of certain constitutional provisions regarding BSE committees, clarification of the BSE's membership provisions, and changes in the composition of the BSE's Nominating Committee in order to provide for a greater diversity of representation among member firms.

NASD

The NASD, the only national securities association registered with the Commission, has over 6,500 member firms. In fiscal year 1990, the NASD reported a total of 1,011 final disciplinary actions, consisting of 893 formal and summary disciplinary actions by its district committees and 118 formal and summary actions by its NASDAQ and market surveillance committees.

In addition, in fiscal year 1990, the Commission received 64 filings of proposed rule changes and approved 58 proposed rule changes. Among the significant rule changes approved by the Commission, in addition to those discussed above in the section on “Securities Markets, Facilities, and Trading,” were: (a) proposals relating to qualification standards for NASDAQ/NMS securities, and, in particular, requirements for shareholder approval of certain issuances of securities;[187] and (2) a proposal that prohibits NASDAQ market makers from entering agency orders into the NASD's Small Order Execution system, while reiterating a market maker's obligation to obtain best execution for its customer orders.[188] The Commission also approved rule changes that prohibit the disenfranchisement of

common stock shareholders of issuers included in the NASD's NASDAQ/NMS system,[189] and a proposal that allows the NASD to institute expedited remedial action against a NASD member or associated person if the member or person has engaged, and there is a reasonable likelihood that the member or person will again engage, in securities law violations.[190] Additionally, the Commission approved a NASD proposal that requires NASD members to make reasonable efforts to obtain information from customers concerning their financial status, tax status, investment objectives, and such other information used or considered to be reasonable and necessary by the member in making investment recommendations to the customer.[191]

Clearing Agencies

During fiscal year 1990, the Commission received 114 proposed rule changes from registered clearing agencies. Ninety-two rule changes from those clearing agencies were approved, and three were withdrawn. For example, the Commission approved a proposed rule change by NSCC that limits the use of letters of credit to meet a member's required clearing fund contribution to 70 percent of the member's required deposit.[192] The Commission also approved NSCC's proposal to include in NSCC's continuous net settlement system member transactions in book-entry-only municipal securities.[193] The Commission also approved, on a temporary basis, a rule change by the Midwest Securities Trust Company that expanded participant eligibility to include certain insurance and investment companies.[194] In addition, the Commission approved MBSCC's proposal regarding its Settlement Balance Order (SBO) system, which, among other things, introduces two-side reporting and comparison of SBO trades, provides procedures for the resolution of uncompared trades, and revises the SBO Cash Adjustment.[195]

Municipal Securities Rulemaking Board

The Commission received nine proposed rule changes from the Municipal Securities Rulemaking Board (MSRB) and approved 10 MSRB rule filings. At the close of fiscal year 1990, three MSRB rule filings were pending.

Of particular note among the approved rule filings was the adoption of MSRB Rule G-36, which requires underwriters to submit copies of final official statements and other documents to the MSRB for certain new-issue municipal securities.[196] The proposal also established a public access facility for copying documents.

Inspections of SRO Surveillance and Regulatory Compliance

The Commission staff conducted an inspection of the NASD's Anti-Fraud Department, reviewing procedures and cases pertaining to serious market manipulation and sales practice abuses. The inspection generally disclosed thorough investigations conducted by the NASD staff with a few minor deficiencies involving case resolution and documentation. The staff concluded that the Anti-Fraud Department administers an effective enforcement and regulatory program and, in particular, found that members' retail mark-ups on OTC securities were analyzed in a manner consistent with NASD guidelines and relevant Commission decisions.

The staff also conducted an inspection of the NYSE Division of Enforcement, concentrating primarily on that division's procedures and cases originating from regulatory programs administered by the exchange. The inspection considered the adequacy of investigations and sanctions in cases opened by the exchange since 1987 and closed in 1988 and 1989. The staff concluded that, overall, the exchange is enforcing its members' compliance with the federal securities laws and NYSE rules in a satisfactory manner. The staff

also noted a significant improvement in the NYSE's enforcement program as a result of the implementation of a new and expanded management structure, increased staff, and revised case management procedures. The staff found that although the cases reviewed reflected thorough investigations and meaningful sanctions, some minor deficiencies existed in Enforcement's documentation of investigations and processing of cases. Thus, the staff suggested that the NYSE's enforcement division continue to seek enhanced monitoring and development of future investigations.

The staff conducted an inspection of the work of the NASD's National Business Conduct Committee (NBCC) to assess the organization and role of the NBCC and to evaluate the NBCC's exercise of authority in formal disciplinary matters. In particular, the inspection focused on the NBCC's ability to ensure uniform application of NASD procedures and rules among the 14 NASD district offices. The staff concluded that, in general, the NASD's NBCC operates an effective and thorough program, and that the NBCC attains uniformity among the districts' disciplinary proceedings. Minor deficiencies in the program were found, including instances where the NBCC did not review? cases in which the sanctions imposed by the local committees were below the NASD Guidelines for Determining Remedial Sanctions. The staff made pertinent recommendations to correct those deficiencies.

The staff conducted an inspection of the NYSE's Department of Arbitration to evaluate the effectiveness of the NYSE arbitration program in the processing and resolution of disputes between NYSE members and their customers. In particular, the staff considered whether new rule changes, adopted by the NYSE in May 1989 in response to Commission concerns regarding the rules and procedures governing SROs sponsored by Arbitration, were successful in improving the documentation and fairness of cases

administered by the exchange. The staff also reviewed the adequacy and thoroughness of case documentation, the efficiency of the case management system, and the role of the Arbitration Department in processing cases. While the inspection revealed substantial deficiencies in case administration and file management, the staff concluded that the Arbitration Department generally administers a fair and efficient program with improved case management occurring after recent amendments to NYSE arbitration rules and procedures. The staff made several recommendations to remedy the weaknesses.

The staff conducted an inspection of the Amex's Options Sales Practice Department and Enforcement Department, which are responsible for detecting options sales practice abuses during broker-dealer examinations and investigations and enforcing compliance with the federal securities laws and Amex rules. The staff concluded that, overall, these departments conduct extensive and well-documented investigations and that the Amex had satisfactorily addressed the deficiencies noted in previous inspections conducted in 1986 and 1988. The staff noted, however, that (1) sales practice examiners did not always conduct sufficient reviews for all sales practice issues, such as suitability, and (2) that the Amex did not adequately resolve all apparent violations. Thus, the staff recommended that the Options Sales Practice Department revise its procedures to ensure adequate and consistent determinations of all apparent violations. In addition, the staff found that Enforcement Department investigations generally were thorough and sanctions were appropriate; however, the staff recommended improved file maintenance to address minor documentation deficiencies in a few cases.

The staff also reviewed the Amex Examinations Division's financial surveillance and broker-dealer examination programs for six members conducting business with public customers for which the

Amex serves as designated examining authority. The staff noted some minor deficiencies and recommended improved workpaper documentation and review, expanded sales practice reviews and documentation, and improved analysis for compliance with the possession and control requirements of Rule 15c3-3.

The Commission's nine regional offices conducted routine oversight inspections of regulatory programs administered by eight of the NASD's 14 district offices. These inspections included evaluations of the districts' broker-dealer examinations and their financial surveillance and formal disciplinary programs, as well as investigations of customer complaints, terminations of registered representatives for cause, and members' notices of disciplinary action. Although these inspections disclosed several deficiencies involving a variety of issues, most were characterized as less serious in degree and magnitude. Overall, these inspections revealed that the NASD districts were effectively meeting their regulatory responsibilities.

The staff also conducted an inspection of the surveillance, investigatory, and disciplinary programs of the NYSE for trading in equity and index options. The staff found that, overall, the NYSE programs were functioning adequately for the current level of equity and index options trading on the exchange. The staff found, however, that current staff resources for the Options and Special Product (OSP) unit were barely sufficient to review NYSE options trading as well as program and related stock index futures and options trading, an area where the unit also has responsibility. The staff found relatively lengthy completion times for options trading investigations, including less difficult investigations such as for position limit, trade adjustment, and audit trail reporting violations. As a result, the division recommended that the NYSE critically examine present

staffing levels of the OSP unit to determine whether the allocation of additional resources is warranted.

The staff also completed an inspection of the surveillance, investigatory, and disciplinary programs of the NYSE for program trading and related trading in stock index futures and options. The staff recommended that the NYSE develop automated quality check procedures to monitor the accuracy of the daily program trading reports submitted to the NYSE by members, evaluate the feasibility of accelerating the process of collecting program trading data for incorporation into routine surveillance procedures and trading reconstructions, expand its collection of program trading data, and more aggressively institute disciplinary actions against members who repeatedly submit inaccurate or incomplete information. The staff also conducted and completed special purpose inspections of the systems, policies, and procedures designed to develop and monitor the production of options audit trails of the two most active options exchanges, the Amex and the CBOE. The staff found that, overall, while the Amex and CBOE options audit trails were conceptually sound, the accuracy of the audit trails of both exchanges needed continued improvement. The staff recommended that the exchanges take regulatory actions to improve compliance levels by floor members. The staff also recommended that the exchanges perform immediate audits to address systemic problems in floor reporting procedures and impose more stringent requirements for time stamping of order tickets.

The staff also conducted and completed special purpose inspections of the systems, policies, and procedures designed to develop and monitor equity audit trails at the three primary equities markets- -the NYSE, Amex, and NASD. The staff concluded that the equity audit trail systems at these three SROs generally were sound. The staff found no major systemic flaws or weaknesses in the procedures to

reconstruct trading, although the report noted the need for improvements in both completeness and accuracy.

Finally, the staff prepared a report on trading and price volatility experienced in the securities markets on October 13 and 16, 1989. The report contained an analysis of program trading and related stock index futures and options trading strategies on market volatility during this period. In this report, the staff found that: (1) futures selling was focused in speculative accounts, foreign accounts (which the division identified as mostly short-term speculative trading accounts), options market makers and major broker-dealers that were hedging large institutional options put writing and (2) floor traders (locals) at the Chicago Mercantile Exchange, Inc. (CME), the largest market for stock index futures contracts, did not provide net liquidity to the market. At critical times during the price declines on October 13, locals were active sellers. When the decline began, selling by locals hit a peak of 50.1 percent of the total S&P futures sell volume.

In addition, the staff found that, unlike the 1987 market break, stock index futures selling was not dominated by institutions. Instead, at critical times during the decline on October 13, institutions were net buyers. As in the case of the 1987 market break, however, the staff also concluded that index arbitrage and other program selling significantly accelerated and exacerbated the market decline. A number of these index arbitrage transactions were not executed contemporaneously but rather were “legged” in a manner that more closely resembled short-term speculative trading. Finally, the imposition of the CME's 12-point price limit for the S&P futures coincided with a sharp drop off in the level of program selling on the NYSE and a reduction in the rate of the price decline in stocks. While a direct causal relationship is difficult to establish, at a minimum, the staff's findings did not indicate any harm to the markets attributable to the imposition of the circuit breaker mechanisms.

Applications for Re-entry

During fiscal year 1990, the Commission received 50 SRO applications to permit persons subject to statutory disqualification, as defined in Section 3(a)(39) of the Exchange Act, to become or remain associated with broker-dealers. The distribution of filings among the SROs was: NASD -- 39; NYSE -- 9; Amex -- 1; and MSE -- 1. Of the total filings processed in 1990, including those received but not completed in 1989, one was subsequently withdrawn, forty-seven were completed, and two were pending at year-end. No applications were denied.

SRO Final Disciplinary Actions

Section 19(d)(l) of the Exchange Act and Rule 19d-1 thereunder require all SROs to file reports with the Commission of all final disciplinary actions. A Rule 19d-1 filing reports the facts about a completed action that may have been initiated at any time during the previous years. The time needed to complete a SRO disciplinary action frequently reflects the severity of the violation(s) charged, the number of respondents involved, and the complexity of the underlying facts. SROs generally conclude cases involving minor or technical violations with a single respondent in less than a year. Cases involving serious trading violations *(e.g.,* price manipulation, insider trading, frontrunning, *etc.)* require more time to complete because of the necessity of demonstrating specific intent to the disciplinary panel that acts as trier of fact. Consequently, the absolute volume of Rule 19d-1 notices submitted by a SRO in a given year is not a precise measure of its proficiency in market surveillance and compliance. Nevertheless, the number of actions reported can be useful in assessing the regulatory effectiveness of different SROs over similar

time periods, and this information has proven useful in focusing inspections of SRO regulatory programs.

In fiscal year 1990, the Amex filed 36 Rule 19d-1 reports; the BSE filed one; the CBOE filed 160; the MSE filed 5; the NYSE filed 230; the Phlx filed 125; the PSE filed 37; the registered clearing agencies, the Cincinnati and Spokane Stock Exchanges filed none; and the NASD filed 1,011.[197]

Securities Investor Protection Corporation (SIPC)

The SIPC Fund amounted to $557.4 million on September 30, 1990, an increase of $107.1 million from September 30, 1989. Further financial support for the SIPC program is available through a $500 million confirmed line of credit established by SIPC with a consortium of banks. In addition, SIPC may borrow up to $1 billion from the United States Treasury Department, through the Commission.

INVESTMENT COMPANIES AND ADVISERS

The Division of Investment Management oversees the regulation of investment companies and investment advisers under two companion statutes, the Investment Company Act of 1940 (Investment Company Act) and the Investment Advisers Act of 1940 (Investment Advisers Act), and administers the Public Utility Holding Company Act of 1935 (Holding Company Act).

Key 1990 Results

The tables below show the number and size in terms of assets of registered investment companies and investment advisers and the number of examinations of those registrants performed over the last five years.

[table omitted]

The number of registered investment companies decreased by less than one percent during fiscal year 1990. The lack of growth in the number of registered investment companies may be attributed, in part, to the fact that many investment companies combined several separate portfolios or investment series in one investment company registration statement. The Division of Investment Management estimates that the fiscal year 1990 registrant population consisted of 16,600 separate portfolios or series of investment companies. Registered investment companies added 630 new portfolios or series during fiscal year 1990, an increase of 3.9 percent. The number of registered investment advisers grew by 7.1 percent and the assets they manage increased by 11.4 percent.

During fiscal year 1990, the number of investment company examinations completed increased by 25.7 percent over the prior year. Investment adviser examinations also increased by 9.3 percent during the same period.

Key 1990 results included the formation of a task force to reexamine the regulation of investment companies and the publication of a concept release requesting comments on issues identified by the task force. The Commission issued proposed amendments to Rules 2a-7, 6c-9, and 31a-2 under the Investment Company Act. The Commission also adopted Rule 52 under the Public Utility Holding Company Act to allow the issuance and sale of certain securities to proceed without filing an application in certain circumstances and issued a notice requesting comment on the need to eliminate or modify any of the conditions in Rule 52 as adopted.

Reexamination of the Regulation of Investment Companies

In March 1990, the Commission formed a task force to reexamine the regulation of investment companies. The task force is expected to make recommendations concerning legislation and rules to reform the regulatory structure of investment companies. Issues examined by the task force include: (1) internationalization and cross-border sales of investment company and investment advisory services; (2) alternative structures for investment companies; (3) securitization of assets under the Investment Company Act; (4) distribution of the shares of open-end investment companies; (5) repurchase of shares by closed-end investment companies; (6) advertising by open-end companies under the Securities Act of 1933 (Securities Act) and the prospectus delivery requirements for unit investment trusts and open-end companies; (7) reform of insurance product regulation; and (8) bank involvement with investment companies. On June 15, 1990, the

Commission issued a concept release seeking comment on these and other issues.[198]

EDGAR Filings

Nearly half of all active registered management investment companies are now making electronic filings on Form N-SAR. The Division of Investment Management is working with the Office of Information Systems Management to develop an efficient means to transfer the information contained in these filings to a database that will permit automated analysis of the information. This database will be a useful resource in the investment company inspection program and other Commission activities.

Regulatory Policy

Significant Investment Company Act Developments

In July 1990, the Commission proposed for public comment amendments to rules and forms affecting money market funds, including an amendment to Rule 2a-7 under the Investment Company Act, which permits money market funds to maintain a stable price of $1.00 per share.[199] The proposed amendments would require prominent disclosure that fund shares are neither insured nor guaranteed by the United States government and that there is no assurance that the fund will be able to maintain a stable price per share. The proposed amendments would reduce the dollar-weighted *average* portfolio maturity of money market funds from 120 days or less to 90 days or less and require that no money market fund portfolio security have a maturity in excess of two years.

In addition, money market funds (other than tax-free money market funds) would not be able to (1) invest more than five percent of fund

assets in the securities of any one issuer, except the United States government, (2) invest more than one percent of fund assets in the securities of an issuer carrying a rating from any nationally recognized statistical rating organization (NRSRO) that is less than the highest rating issued by the NRSRO, or (3) invest more than five percent of total fund assets in securities having less than the highest rating of an NRSRO. A security would have to be rated “high quality” by all NRSROs rating the security. The proposed revisions also specify the actions that a fund must take if it holds securities that have gone into default or the ratings of which have been downgraded. Finally, the rule would require that any fund holding itself out as a money market fund but not relying on Rule 2a-7, meet the conditions of the rule relating to portfolio diversification, quality, and maturity.

During fiscal year 1990, the Commission proposed an amendment to Rule 6c-9 to expand the exemption from registration under the Investment Company Act to include the offers and sales of equity securities by foreign banks. The proposed amendment also would exempt the offers and sales of securities by foreign insurance companies, Canadian trust companies and loan companies, and foreign bank and foreign insurance holding companies that meet certain requirements.[200] The proposed amendment would eliminate the need for these foreign entities to obtain exemptive orders with respect to such offers and sales. The Commission also issued an interpretive release stating its position that United States branches and agencies of foreign banks, for the limited purpose of issuing securities in the United States, will be considered banks under the Investment Company Act and exempted from registration as investment companies.[201]

The Commission proposed an amendment to Rule 31a-2 under the Investment Company Act to clarify the location and language aspects

of the recordkeeping requirements for United States registered investment companies, particularly those United States investment companies that invest in foreign securities.[202] The proposed amendment requires that a set of those books and records forming the basis for financial statements (required to be maintained by United States investment companies under certain provisions of Rule 31a-1 under the Investment Company Act) must be preserved in the United States, and that such books and records, if created by the United States investment company, must be preserved in the English language.

Significant Public Utility Holding Company Developments

As of June 30, 1990, 13 gas and electric public utility holding companies were registered under the Public Utility Holding Company Act of 1935 (Holding Company Act). This total is comprised of 67 electric or gas utility subsidiaries, 106 non-utility subsidiaries, and 39 inactive companies, for a total of 212 companies operating in 24 states (excluding seven power supply subsidiary companies). These registered systems had aggregate assets of $93.1 billion as of June 30, 1990, an increase of $900 million over June 30, 1989. Total operating revenues for the 12 months ended June 30, 1990 were $35.4 billion, a $1.2 billion increase from the 12 months ended June 30, 1989.

During fiscal year 1990, the Commission authorized the issuance of nearly $5 billion of senior securities and common stock financing for the 13 registered systems consisting of $3.9 billion in long-term debt financing and $1.1 billion in common and preferred stock. Long-term debt financing decreased by 2.5 percent from fiscal year 1989 primarily due to the volume of refinancing undertaken in prior years. Additionally, $262 million in pollution control financing and $4.6 billion in short-term debt financing were approved. Pollution control

financing increased 55 percent from amounts authorized in fiscal year 1989. Short-term debt decreased 41 percent from the previous fiscal year. The Commission also authorized $205 million of investments in qualified cogeneration and small power production facilities and energy management and audit systems. Total financing authorizations decreased 34.8 percent over 1989, from $15.5 billion to $10.1 billion. Finally, the Commission authorized $340 million for nuclear fuel, and oil and gas development and exploration in fiscal year 1990.

The Commission audits service companies. It also reviews the fuel procurement activities, accounting policies, annual reports of registered holding company subsidiary service companies and fuel procurement subsidiaries, and quarterly reports by registered holding company non-utility subsidiaries. Electric utility subsidiaries of registered holding companies were required to reduce the cost of fuel billed to customers by the amount of revenues gained from (a) the sale of excess oil and gas to non-associate companies and (b) subleasing and transloading of coal and oil barges. Approximately $22.6 million in savings to consumers was realized as a result of this requirement.

The Commission adopted one rule during fiscal year 1990. Rule 52 allows the issuance and sale of certain securities by public utility subsidiary companies of registered holding companies to proceed without filing an application, provided certain conditions are met.[203] The Commission adopted Rule 52 essentially as proposed to permit the immediate realization of the rule's benefits. The Commission also issued a notice requesting comments on the need to further revise Rule 52 to eliminate or modify certain of the existing conditions.[204]

Significant Institutional Disclosure Program Developments

Section 13(f)(l) of the Securities Exchange Act of 1934 (Exchange Act) and Rule 13f-1 require specified “institutional managers” to file quarterly reports on Form 13F. Under Rule 13f-2(T), these managers may file the report on Form 13F-E through magnetic tape by using the Commission's pilot Electronic Data Gathering, Analysis, and Retrieval (EDGAR) system. Managers filing these reports disclose specified equity holdings of the accounts over which they exercise investment discretion. For the quarter ended September 30, 1990, Form 13F reports were filed by 1,003 managers for total holdings of $1.3 trillion. Sixty managers of this group reported holdings over $90 billion.

Form 13F reports are available to the public at the Commission's Public Reference Room promptly after filing. Two tabulations of the information contained m these reports are available for inspection: (1) an alphabetical list of the individual securities showing the number of shares held by the managers reporting the holding and (2) a list with the total number of shares of a security reported by all reporting managers. Both tabulations normally are available two weeks after the date on which the reports must be filed.

Significant Applications and Interpretations

Investment Company Matters

On October 19, 1990, the Commission sued a conditional order on an application filed by The SuperTrust Trust for Capital Market Shares, Inc.[205] The order granted applicants an exemption under Section 6(c) of the Investment Company Act from Sections 4(2) and 22(d) of the Act and Rule 22c-1 thereunder and approved an offer of exchange under Sections 11 (a) and 11 (c) of the Act. The order permits a unit investment trust to issue redeemable securities that are divisible into non-redeemable components, authorizes secondary market

transactions in such redeemable securities at negotiated prices, and approves the exchange of shares of an open-end management company for units of beneficial interest in a unit investment trust.

In August 1990, the Commission granted an exemption from the Investment Company Act to a public finance authority established by the State of Western Australia to enable it to issue and sell debt securities in the United States.[206] The exemption will provide Western Australia with an alternate source of funding for the operations of certain public authorities in Western Australia.

In February 1990, the Commission staff learned that Smith Barney, Harris Upham & Co. was disqualified from serving investment companies in certain capacities because it employed three registered representatives subject to injunctions for securities-related offenses. After determining that these employees were not involved in Smith Barney's investment company activities, the Commission issued an order on May 21, 1990 permitting the company to continue its investment company activities on the condition that it review and revise its compliance procedures to avoid future violations of this sort.[207] The publication of the Commission's order prompted similar applications and compliance reviews by other financial services firms.

Enforcement action was not recommended by the staff where a fund complex allowed shareholders to exchange fund shares automatically in and out of money market funds when share prices of a non-money market fund move above or below thresholds to be designated by the shareholder. Specifically, shareholders could place orders to (1) redeem shares in a money market fund and buy shares in a non-money market fund at any specified price below the current net asset value of the non-money market fund and (2) redeem shares of a non-money market fund and buy shares of a money market fund at any

specified price above the current net asset value of the non-money market fund.[208]

The staff also declined to recommend enforcement action under Section 18(f) of the Investment Company Act where a fund that writes a straddle (a hedging strategy involving the use of both call and put options), under certain limited conditions, segregates qualifying liquid assets in a certain manner. The staff also stated that a segregated account would eliminate the potential senior security problems arising from the writing of a “put” by an investment company only if that segregated account consisted entirely of liquid assets other than the security or instrument on which the “put” has been written.[209]

Tender option bonds are long-term fixed rate bonds that have been coupled with a third-party “put” permitting bondholders the option to tender their bonds to the third-party at periodic intervals and receive the face value thereof. Outside counsel represented that the third-party “put” and the payment of periodic tender fees to the third-party would convert long-term fixed rate bonds to synthetic short-term variable rate demand instruments. The staff stated that it would not recommend enforcement action if, in reliance on Rule 2a-7 under the Investment Company Act, certain money market funds purchase tender option bonds and value the instruments at amortized cost. The staff conditioned no-action relief, in part, on representations that the funds would purchase the tender option bonds only under certain conditions listed in the staff's response.[210]

The staff decided not to recommend enforcement action under Section 30(d) of the Investment Company Act or Rule 30d-1 thereunder and Rule 14a-3(e) of the Exchange Act if, under certain conditions, funds sent single copies of annual and semi-annual reports to an address at which more than one registered shareholder of a fund indicated mail is to be delivered.[211]

The staff declined to grant no-action relief under Rules 482 of the Securities Act and 34b-1 under the Investment Company Act where a mutual fund sought to exclude performance results before a new adviser assumed management responsibilities for the fund.[212] The staff indicated that because the president and a director of the fund's previous adviser became the president of the new adviser, the performance results of the previous adviser should not be excluded from calculations of average annual total return. The staff noted that Rule 482 requires fund performance to be calculated for one-, five-, and ten-year periods; the only exception to that requirement is when the performance results of the fund would include the performance results of an unrelated previous adviser.

Investment Advisers Act Matters

The staff granted no-action relief under the Investment Advisers Act custody rule where an adviser to a limited partnership (Partnership) made withdrawals of its advisory fees or capital investment in the Partnership directly from the Partnership's account with an independent custodian. The granted relief required that an attorney or independent certified public accountant for the Partnership authorize the withdrawals.[213]

The staff stated that it would not recommend enforcement action if a registered investment adviser collected performance-based fees from offshore funds that were offered exclusively offshore to non-United States persons where certain conditions were satisfied. Since the funds did not have to rely on the private investment company exclusion to avoid registration under the Investment Company Act, the staff indicated that they should not be deemed to be “private investment companies” within the meaning of Rule 205-3. This rule creates an exemption from the prohibition against compensation

based on a share of capital gains upon, or the capital appreciation of, the client's funds in Section 205(a)(D of the Investment Advisers Act.[214]

Holding Company Act Matters

The Commission authorized Entergy Corporation (Entergy), a registered holding company, to form Entergy Power, Inc. (EPI) as a bulk power marketing subsidiary that would acquire two electric generating facilities from an associate company, Arkansas Power & Light Company (AP&L), an electric public utility subsidiary of Entergy. The related power would be marketed wholesale to non-associate companies.[215] The Commission found that EPI's sale of power at wholesale to non-associate companies would result in economies and efficiencies that would inure to the benefit of AP&L and the Entergy system generally. In taking this action, the Commission denied requests for hearing filed by the Council of the City of New Orleans, the Louisiana Public Service Commission, the Mississippi Attorney General and the Arkansas Electric Energy Consumers (AEEC), an association of industrial and agricultural electric power customers of AP&L.

The Commission authorized Entergy to organize Entergy Operations, Inc. (EOI) as a new wholly owned subsidiary service company that will manage and operate all nuclear power facilities owned by Entergy system operating companies, including AP&L.[216] The Commission concluded that the organization of EOI as a nuclear management service company for the purpose of consolidating the management and operations of the Entergy system's nuclear plants will benefit the integrated system by producing economies and efficiencies that could not be achieved under separate management by the individual operating companies. The Commission denied the request for hearing filed by AEEC.

The Commission's order authorizing WPL Holdings, Inc. (WPL) to reorganize from an operating utility and holding company into a predominantly intrastate public utility holding company[217] was remanded by the United States Court of Appeals for the District of Columbia Circuit.[218] On remand, the Commission issued a Supplemental Memorandum Opinion and Order clarifying the finding in its initial order that the proposed reorganization will serve the public interest by tending toward the efficient and economical development of an integrated public utility system.[219]

Northeast Utilities (Northeast) filed an application proposing the acquisition of Public Service Company of New Hampshire (PSNH), an investor owned public utility company. PSNH is currently a debtor-in-possession in reorganization proceedings under Chapter 11 of the United States Bankruptcy Code (Bankruptcy Code), pursuant to a plan of reorganization (Plan) confirmed by the Bankruptcy Court on April 20, 1990. The Plan places an aggregate valuation on PSNH of approximately $2.3 billion, including PSNH's 35.6 percent undivided interest in the Seabrook Nuclear Power Project which is valued at $700 million. The $2.3 billion is to be made available for distribution to PSNH's creditors and shareholders. The Plan stipulates that, if all necessary regulatory approvals are received by December 31, 1990, unless otherwise extended, the acquisition will proceed as a direct acquisition of PSNH; otherwise, the acquisition will be accomplished through a merger. A notice of the filing of the application has been issued by the Commission,[220] and 41 requests for hearing have been filed, 20 of which were subsequently withdrawn. Eight additional entities filed comments and notices of appearance.

Eastern Utilities Associates (EUA), a registered holding company, filed an application to acquire the outstanding common stock of Fitchburg Gas and Electric Light Company (Fitchburg), a

Massachusetts public utility company, and UNITIL Corporation, a New Hampshire exempt electric public utility holding company, by cash tender offers of $36 and $40 per share, respectively. EUA estimates the cost of its acquisition of Fitchburg and UNITIL at approximately $47.1 million and $31.9 million, respectively. A notice of the filing of the application was issued by the Commission,[221] and requests for hearing were filed by UNITIL and Fitchburg.

Subsequently, UNITIL and Fitchburg filed an application seeking authorization for UNITIL to acquire Fitchburg, which will become a wholly owned subsidiary of UNITIL. As a result of the transaction, UNITIL will become a registered holding company under the Holding Company Act. A notice of the filing of the application was issued by the Commission,[222] and a request for hearing was filed by EUA.

The Commission authorized the formation of CIPSCO Incorporated (CIPSCO), an Illinois corporation, and CIPSCO's acquisition of Central Illinois Public Service Company, an investor owned public utility company and an exempt holding company under the Holding Company Act.[223] Through this acquisition, CIPSCO indirectly acquired 20 percent of the outstanding shares of common stock of Electric Energy, a jointly owned company that operates a 1,000 megawatt electric generating station. By this action, the Commission permitted a company that is both an operating company and a holding company exempt from regulation under the Holding Company Act to reorganize in order to facilitate diversification.

Insurance Products Matters

The staff issued a letter stating that it would not recommend any enforcement action to the Commission for a *per se* violation of Section 17(a) of the Securities Act, or Rule 156 thereunder, if Pacific Mutual Life Insurance Company furnished certain “qualified

institutional investors" (defined as non-natural persons having $100 million or more in assets) with individualized variable life illustrations having hypothetical gross rates of return that may exceed 12 percent.[224] The proposed illustrations were to be used only as supplemental sales literature. The no-action relief was based on representations that the illustrations would be furnished only upon request to qualified institutional investors, and not used in connection with employee benefit plans under which participants exercise investment discretion with respect to assets allocated to accounts maintained on their behalf.

The staff determined that it would no longer respond to no-action requests from separate accounts and their depositors for permission to stop filing post-effective amendments and delivering updated prospectuses when (a) contracts are no longer being sold; (b) there is a relatively small number of existing contract owners; and (c) the sponsoring insurance company undertakes to provide contract owners with certain information about the contract, the separate account, and the underlying fund.[225] When the Commission adopted Forms N-3 and N-4, it declined to consider a rule to exempt registrants from maintaining a current prospectus with respect to discontinued variable annuity contracts but stated that the Commission staff would consider any requests for such relief on a case-by-case basis.[226] The staff has considered numerous requests for relief from the continuous updating requirement since the Commission adopted Forms N-3 and N-4 and has described the particular information that must be provided to variable contract owners as a condition for no-action assurance. The staff believes that similarly situated registrants should be permitted to rely on those prior letters.

A letter was issued by the staff which stated that it would not recommend any enforcement action to the Commission under Rule

22c-1 of the Investment Company Act if the College Retirement Equities Fund (CREF) allocates initial premiums to the money market account pending receipt of a completed application for certain variable annuity contracts.[227] This position was based on a determination that neither CREF nor any affiliate stood to be enriched, through advisory fees or sales charges, by retaining initial premiums for incomplete applications and allocating them to the Money Market Fund. CREF's allocation procedures would be fully disclosed in the prospectuses for CREF certificates, and applicants would be required to acknowledge their understanding of the allocation practice in the CREF applications.

FULL DISCLOSURE SYSTEM

The full disclosure system is administered by the Division of Corporation Finance (Division). The system is designed to provide investors with material information, foster investor confidence, contribute to the maintenance affair and orderly markets, facilitate capital formation, and inhibit fraud in the public offering, trading, voting, and tendering of securities.

Key 1990 Results

The decline in the number of registered offerings, acquisitions, and tender offers filed with the Commission, which began following the October 1987 market break, continued in fiscal year 1990. Registration statements filed with the Commission in fiscal year 1990 totaled 2,784, representing approximately $226 billion of debt securities and approximately $99 billion of equity securities (exclusive of post-effective amendments and filings that become effective without staff action, including dividend reinvestment and employee benefit plans that registered approximately $52 billion of equity securities). This total was 11 percent less than the 3,139 registration statements filed in fiscal year 1989 (covering approximately $219 billion of debt securities and $124 billion of equity securities). In addition, initial public offerings (IPOs) registered with the Commission decreased approximately 32 percent from 1989 and approximately 45 percent in dollar terms. The number of IPO registration statements filed on Form S-18 declined 44 percent (588 in 1989 versus 327 in 1990), while the dollar amount declined approximately 48 percent ($2.3 billion in 1989 versus $1.2 billion in 1990). Finally, third party

tender offer filings (Schedules 14D-1) fell approximately 50 percent to a seven-year low, while merger/going-private proxy statements dropped 15 percent from the prior year.

A task group of accountants was organized during the year to conduct comprehensive reviews of the financial statements, management's discussion and analysis (MD&A), and other related disclosures in the Securities Exchange Act of 1934 (Exchange Act) reports of selected banks and savings and loan associations. These reviews were in addition to those of financial institutions making transactional filings.

Regional offices continued to receive and review registration statements for blank check offerings and post-effective amendments containing financial statements and descriptions of properties and businesses acquired with the proceeds of these types of offerings. Of the 327 total IPO filings received in fiscal year 1990, approximately 47 percent involved blank check offerings. Regional office staff also referred approximately 100 matters for enforcement inquiry and investigation, more than twice the number referred in fiscal year 1989.

In fiscal year 1990, the implications of increasing internationalization of the securities markets continued to be a major focus of the full disclosure program. The Commission took action to reduce the costs of capital by increasing the efficiency of the private market with the adoption of Rule 144A, and by streamlining the procedures for offering securities offshore with the adoption of Regulation S. The Commission also reproposed its multijurisdictional disclosure system with Canada, whereby companies will be able to use home country disclosure documents in cross-border offerings. This proposed initiative will be used as a prototype for similar efforts with other jurisdictions.

The Commission has focused increasingly on problems presented by rights offerings and tender and exchange offers relating to such securities as a result of the increase in United States investor holdings of foreign securities. Over the past year, the Commission has sought in a variety of ways to address the problem of exclusion or discriminatory treatment of United States shareholders in connection with multinational cash tender and exchange offers. United States holders of foreign securities not only can be deprived of the opportunity to realize significant value on their investments by tendering into a favorable offshore offer, but they also may be forced to decide whether to retain their securities or sell into the secondary markets without the disclosure and procedural safeguards afforded by the regulations of either the United States or the relevant foreign jurisdiction.

In addition to the multijurisdictional disclosure approach, the Commission is exploring alternative solutions to these issues. One possible approach is to permit offers to be made in the United States, where United States investors comprise such a small portion of the company's securityholder base that a foreign bidder would otherwise likely exclude them based on a determination that the cost of compliance with United States laws and regulations outweighs the benefits of including United States shareholders in the offer. The Commission also is seeking comment on a number of specific issues relating to the manner in which such an approach might be implemented, including the appropriate threshold of United States ownership and whether certain protections should be present before the United States will recognize the foreign regulatory scheme.

The Commission has sought to administer existing rules in a flexible manner to accommodate foreign tender offer rules and practices in order to ensure the participation of United States securityholders in

multinational tender and exchange offers. The key policies in tailoring such accommodations have been to provide to the greatest extent possible for the equal treatment of shareholders, both United States and foreign, and to afford United States investors the fundamental protections under the Williams Act.

The Commission issued an order in connection with the cash tender offer by Ford Motor Company Limited for all shares of the British company Jaguar Plc, which served to reconcile conflicting United States and United Kingdom tender offer provisions, thereby enabling Ford to open the offer to United States holders, who in the aggregate held more than 25 percent of Jaguar's shares.[228] The order provided exemptive relief from the Commission's withdrawal rights requirements in order to permit the United States and United Kingdom offerings to proceed simultaneously in accordance with United Kingdom requirements.

The Commission granted relief from certain tender offer regulations to two Swedish companies, Aktiebolaget Volvo and Procordia Aktiebolag, in connection with their offers for another Swedish company, Pharmacia Aktiebolag.[229] The relief permitted the United States holders of target stock to be treated equally with foreign holders, including use of a common proration pool, and allowed tender and exchange offers to be extended simultaneously to United States securityholders pursuant to United States registration, tender offer, and going-private requirements.

In other activity, the Commission proposed revisions to Rule 431 regarding the use of summary prospectuses, transmitted a report on the high-yield bond market to the Senate Banking, Housing and Urban Affairs Committee, and adopted substantial revisions to the procedures for registering employee benefit plan securities.

The staff is actively involved in planning the transition from paper to electronic filing, and in developing the rules for the operational Electronic Data Gathering, Analysis, and Retrieval (EDGAR) system. The conversion will begin during 1991 and will continue for a period of 36 to 48 months. During the next fiscal year, significant resources will be dedicated to EDGAR rulemaking, training, planning, and coordination.

Review of Filings

The Division's financial institutions task group is conducting comprehensive reviews of the financial statements, MD&A, and other related disclosures in the Exchange Act reports of certain banks and savings and loan associations selected for review on the basis of their financial condition. During the year, the task group completed reviews of 191 financial institutions, with 30 issuers being referred to the Division of Enforcement for further inquiry or investigation, in addition to the other 105 referrals made by the Division.

The Division also collected information on oil and gas, real estate, and other industry limited partnership roll-up transactions undertaken since January 1, 1985. The background information is being used in the staff's ongoing review of the disclosure requirements and practices in the area to assess the need for change.

During fiscal year 1990, the staff reviewed 1,907 reporting issuers' financial statements and related MD&A disclosures. Reporting issuers are registrants that file reports under the Exchange Act. The reporting issuer reviews were accomplished through the full review of (1) 838 registration statements and post-effective amendments to registration statements filed under the Securities Act of 1933 (Securities Act); (2) 1,129 annual and subsequent periodic reports; and (3) 240 merger and going-private proxy statements. In addition,

the staff completed 292 full financial reviews of annual reports. The Division was unable to achieve an adequate level of accounting personnel until late in the year. As a result of the recruiting difficulties, as well as the targeted MD&A and financial institution reviews, the number of reporting issuer reviews fell approximately 30 percent from the prior year.

The following table sets forth the number of selected filings reviewed during the last five fiscal years. The decline in reviews of IPOs, tender offers, contested solicitations, and going-private transactions, which are not subject to selective review, reflects the decline in the number of transactional filings in the home office and the regions.

[table omitted]

Rulemaking, Interpretive, and Legislative Matters

Scope of Registration Requirements

The Commission adopted Regulation S, a series of rules intended to clarify the extraterritorial application of the registration provisions of the Securities Act.[230] Regulation S consists of: (1) a general statement that the registration provisions do not apply to offers and sales that occur outside the United States; and (2) two safe harbor rules designed to protect against an indirect offering in the United States. One safe harbor (the issuer safe harbor) applies to offers and sales by issuers, securities professionals involved in the distribution process pursuant to contract, their respective affiliates, and persons acting on behalf of any of the foregoing persons. The other safe harbor (the resale safe harbor) applies to resales by all other persons. Two general conditions apply to the safe harbors. First, the offer and sale must be made in an “offshore transaction,” and second, no directed selling efforts can be made in the United States.

The issuer safe harbor includes three categories of offerings based upon such factors as the location and manner of the offering, the nationality of the issuer, its reporting status in the United States, and the degree of United States market interest in the issuer's securities. The first category includes (1) foreign issuers with no substantial United States market interest in their securities, (2) certain offerings by a foreign or United States issuer directed at a single foreign country, (3) offerings pursuant to certain employee benefit plans, and (4) securities backed by the full faith and credit of a foreign government. Offerings within the first category may be made with no restrictions other than the two general conditions. Offerings within the second category of the issuer safe harbor, offerings of a reporting United States issuer's securities and debt securities of foreign issuers with substantial United States market interest, are subject to additional restrictions, including a 40-day restricted period on offers and sales to United States persons. Offerings within the third, residual category are subject to the most restrictions.

The resale safe harbor rule is available for resales of securities outside the United States. That safe harbor applies restrictions other than the general conditions only to dealers, other persons receiving remuneration in respect of the offered securities, and certain affiliated officers and directors of an issuer or distributor.

Multijurisdictional Disclosure System

The Commission reproposed its multijurisdictional disclosure system with Canada involving proposed rules, forms, and schedules intended to facilitate cross-border offerings of securities by specified Canadian issuers.[231] The rules, forms, and schedules would provide a foundation for a multijurisdictional disclosure system that could be used for a wider class of issuers and in additional jurisdictions. The

Canadian securities regulators in Ontario and Quebec concurrently worked on proposals that would facilitate offerings by United States issuers in Canada.

Resales to Institutional Investors

The Commission adopted Rule 144A, which provides non-exclusive safe harbor exemptions from the registration provisions of the Securities Act for resales of restricted securities to eligible institutions.[232] The exemption provided by Rule 144A is available for offers and sales to "qualified institutional buyers." With the exception of registered broker-dealers, a qualified institutional buyer must in the aggregate own and invest on a discretionary basis at least $100 million in securities of issuers that are not affiliated with that qualified institutional buyer. A lower threshold, $10 million in securities, applies to registered broker-dealers. A registered broker-dealer may also purchase as riskless principal for an institution that is itself eligible to purchase under the rule, or act as agent on a non-discretionary basis in a sale to such an institution. In addition to meeting the $100 million in securities requirement, banks and savings and loan associations must have a net worth of at least $25 million to be qualified institutional buyers. The Commission solicited further public comment on this net worth test. Limited responses have been received and commenters are divided on the necessity and appropriateness of the test.

Restricted securities that, at the time of issuance, were not of a class listed on a United States national securities exchange or quoted in the National Association of Securities Dealers Automated Quotation system (NASDAQ) are eligible for resale under Rule 144A. Convertible securities or warrants that may be exercised for securities so listed or quoted are considered to be the same class as the listed or quoted securities, unless additional requirements relating to

exercise premium and, in the case of warrants, expiration, are satisfied.

Additionally, under certain circumstances, the availability of the rule is conditioned on the holder of the security, and a prospective purchaser from the holder, having the right to obtain from the issuer specified limited information about the issuer, and on the purchaser having received such information from the issuer, the seller, or a person acting on either of their behalf, upon request. This condition applies where the issuer of the securities to be resold under the rule is neither a reporting company under the Securities Act nor a foreign private issuer that is exempt from reporting pursuant to Rule 12g3-2(b) under the Exchange Act, nor a foreign government.

In the first months of the rule's effectiveness, primary transactions making use of the rule's provisions were undertaken principally by foreign issuers placing both debt and equity with United States institutional investors.

Change in Holding Period for Restricted Securities

In the same adopting release for Rule 144A, the Commission adopted amendments to the rules concerning the required holding period for public resale of restricted securities.[233] To sell securities under former Rules 144 and 145, a person must have owned beneficially the securities for at least two years, no matter how long a period has transpired since the issuer or any affiliate thereof originally sold the securities. The amendments redefined the two-year holding period to commence on the date the securities were acquired from an issuer or affiliate, and to run continuously from the date of the acquisition. This eliminated the unnecessarily restrictive requirement that the securities be held for two years by each successive holder before permitting public resales, without regard to the time elapsed

from the actual offering by the issuer or affiliate. A comparable change was made in the calculation of the three-year period prescribed by Rule 144(k).

Regulation of Multinational Tender and Exchange Offers

The Commission issued a concept release soliciting comment on a proposed approach to encouraging foreign bidders to extend multinational tender and exchange offers to United States holders of foreign target securities on the basis of foreign disclosure, procedural and accounting requirements, where United States investors own a small percentage of these securities.[234] The Commission received approximately 25 letters, including a number from foreign jurisdictions.

Summary Prospectuses

The Commission published for comment a release proposing revisions to Rule 431 under the Securities Act regarding the use of summary prospectuses.[235] As proposed, the amendments to Rule 431 would expand the class of issuers that may use summary prospectuses and would conform the filing requirements for summary prospectuses with the requirements for other Section 10 prospectuses. The release also proposed requirements for the inclusion of additional information in summary prospectuses.

High-Yield Bond Study

In March 1990, the Commission transmitted an extensive report on the condition of the high-yield bond market to the Senate Committee on Banking, Housing and Urban Affairs. The report contains available data on the size and parameters of the high-yield primary and secondary markets, and outlines Commission initiatives in examining

the activities, potential exposure and disclosure of broker-dealers, investment companies, insurance companies, and other investors in this area.

Form S-8

The Commission issued a release adopting major revisions to the procedures for registering employee benefit plan securities on Form S-8.[236] The amendments primarily are intended to reduce registrant costs by eliminating the need to prepare and file separate documents for federal securities law purposes that duplicate information otherwise provided to plan participants, while assuring timely delivery of information necessary for participants to make informed investment decisions. Pursuant to the revisions, the plan information (excluding plan financial statements) and a statement of documents available upon request by plan participants must be delivered to participants but are not included in the registration statement and are not filed with the Commission. Plan information does not have to be in the form of a customary prospectus; rather, it can be provided in one or several documents prepared by registrants in the ordinary course of employee communications. Several other amendments also were adopted to facilitate the process of registering and reporting on plan securities, as well as plan interests, which constitute separate securities.

Conferences

SEC Government-Business Forum on Small Business Capital Formation

The ninth annual SEC Government-Business Forum on Small Business Capital Formation was held in Seattle, Washington and Atlanta, Georgia on September 14 and 17, 1990, respectively.

Approximately 150 small business executives, accountants, attorneys, government officials, and other small business representatives were in attendance at each session. The format of the forum combined a brief panel presentation by experts, followed by testimony from local representatives. Also, discussion groups comprised of the panel members and forum attendees were convened. Numerous recommendations were formulated with a view to eliminating unnecessary governmental impediments to small businesses' ability to raise capital. A final report setting forth a list of recommendations for legislative and regulatory changes approved by the forum participants will be prepared and provided to interested persons, including Congress and regulatory agencies.

SEC/NASAA Conference under Section 19(c) of the Securities Act

On April 25, 1990, approximately 40 senior staff officials of the Commission met with approximately 40 representatives of the North American Securities Administrators Association (NASAA) in Washington, D.C. to discuss methods of effecting greater uniformity in federal and state securities matters. After the conference, a final report summarizing the discussions was prepared and distributed to interested persons.

ACCOUNTING AND AUDITING MATTERS

The Chief Accountant is the principal advisor to the Commission on accounting and auditing matters arising from the administration of the various securities laws. The primary Commission activities designed to achieve compliance with the accounting and financial disclosure requirements of the federal securities laws include:

- *rulemaking that supplements private sector accounting standards, implements financial disclosure requirements, and establishes independence criteria for accountants;*

- *review and comment process for Commission filings directed to improving disclosures in filings, identifying emerging accounting issues (which may result in rulemaking or private sector standard-setting), and identifying problems that may warrant enforcement actions;*

- *enforcement actions that impose sanctions and serve to deter improper financial reporting by enhancing the care with which registrants and their accountants analyze accounting issues; and*

- *oversight of private sector efforts, principally by the Financial Accounting Standards Board (FASB) and the American Institute of Certified Public Accountants (AICPA), which establish accounting and auditing standards designed to improve the quality of audit practice.*

Key 1990 Results

Fiscal year 1990 was highlighted by a number of significant public and private sector initiatives intended to enhance the reliability of financial reporting and to ensure that the accounting profession meets its responsibilities under the federal securities laws. In a key initiative, the Commission provided policy direction to the accounting profession to move toward using appropriate market-based measures in accounting for financial institutions. The Commission staff issued two Staff Accounting Bulletins (SABs) to address certain accounting and financial disclosure issues. The Commission also continued to devote significant resources to initiatives involving international accounting, auditing, and independence requirements.

Mark-to-Market Accounting

In the annual report for fiscal year 1989, the Commission noted the FASB's continuing project to address issues of improved accounting guidance for investments in financial instruments. As part of this project, the FASB is assessing whether to expand the use of market value data in financial statements and related disclosures.[237]

Chairman Breeden testified before the Senate Committee on Banking, Housing and Urban Affairs on September 10, 1990 on issues involving financial institutions and accounting principles. The testimony specifically notes that, because it is inherently difficult to distinguish portfolio categories based on intent and ability, particularly considering the dynamic market environment in which investment decisions are made, serious consideration must be given to reporting investment securities at market.[238] In May 1990, the Accounting Standards Executive Committee (AcSEC) proposed rules intended to provide guidance for evaluating the intent and ability of an entity to

hold securities to maturity. A substantial number of commenters criticized this guidance as unworkable, and many suggested it would neither result inconsistent reporting nor would it deal with abuses such as gains trading. In view of the comments received and after considering the views of the Commission and its staff, AcSEC agreed to postpone issuing measurement guidance pending further examination of the issues.

The FASB will consider market value accounting for investment securities by accelerating a portion of its existing project on financial instruments. The Commission will closely monitor this project to ensure progress and to determine whether additional Commission initiatives are necessary.

Accounting-Related Rules and Interpretations

The Commission's accounting-related rules and interpretations serve primarily to supplement private sector accounting standards, to implement financial disclosure requirements, and to establish independence criteria for accountants.

The Commission's principal accounting requirements are embodied in Regulation S-X, which sets forth requirements as to the form and content of financial statements filed with the Commission.

SABs

The Commission staff periodically issues SABs to inform the financial community of the staff's views on accounting and disclosure issues. In fiscal year 1990, SABs were issued to address accounting and financial disclosure issues related to insurance reserves and filings by foreign private issuers, respectively. The first of these bulletins dealt with the appropriate disclosure by property and casualty insurance

companies with respect to certain uncertainties concerning loss reserves.[239] The second bulletin clarified the circumstances under which a foreign private issuer that furnishes a reconciliation of financial measurements prepared under foreign accounting standards that differ from United States generally accepted accounting principles (GAAP) need not present the disclosures required by United States GAAP unless required to do so under the foreign accounting standards under which the financial statements are prepared.[240]

Management Reports

The staff analyzed over 190 comments received on a 1988 rule proposal that, if adopted, would require a company's report on Form 10-K and its annual report to shareholders to include a report from management. The proposed report would describe management's responsibilities for preparing financial statements and for establishing and maintaining a system of internal control directly related to financial reporting. In addition, the report would provide management's assessment of the effectiveness of that internal control system.[241]

There was significant congressional interest in management reports. A bill passed the House of Representatives that would have required Commission registrants to file management reports similar to those proposed by the Commission and would have required a registrant's auditors to examine and report on management's assessment of the internal control system.[242] The Commission did not take a position on this bill, and it was not enacted.

Reviews by Auditors of Interim Information

Commission staff analyzed approximately 175 comments received in response to a concept release seeking comment on the costs and benefits of requiring auditors to review quarterly financial data before it is filed with the Commission.[243] The comments reflected significant concerns about the cost-effectiveness of such a requirement.

Oversight of Private Sector Standard-Setting

Through active oversight, the Commission monitors the structure, activity, and decisions of the private sector standard-setting organizations.

FASB

The Commission and its staff work closely with the FASB and the Financial Accounting Foundation (FAF) in an ongoing effort to examine ways to improve the standard-setting process, including the need to respond to various regulatory, legislative, and business changes in a timely and appropriate manner. As the securities markets become increasingly globalized, the standard-setting process must recognize that United States businesses no longer compete solely within the United States. Therefore, issues regarding the relative costs and complexity of United States financial reporting requirements, when compared with the standards of other countries, must be considered by the standard-setters as they consider the adoption of particular accounting standards that impact United States businesses.

At the request of Chairman Richard Breeden, Commissioner Philip Lochner has been reviewing standard-setting issues with the FASB and other representatives of the accounting profession with a view

toward determining whether there are any actions that the Commission could take to reduce the complexity and costs of United States accounting rules, while maintaining the investor protection and disclosure policies of the federal securities laws. The Commission staff is assisting in this effort and has encouraged a group comprised of major accounting firms to conduct a detailed cost comparison of certain key accounting issues in a number of capital market countries. Such a review is ongoing.

The staff also has encouraged various private sector research projects, such as that being conducted by the Financial Executives Institute's Research Foundation, to explore the impact of differing national accounting requirements. This focus on a comparative analysis of standards in different countries is not intended as an effort to seek the lowest common denominator, but rather as an attempt to identify less costly and complex approaches to accounting issues and to provide recognition of the FASB's efforts to contribute to greater harmony in worldwide reporting requirements.

The private sector continued its efforts directed at improving the standard-setting process. For example, an oversight committee recently formed by the FAF to monitor the FASB's operations on an ongoing basis is planning an extensive review of the FASB's systems and procedures for meeting the objectives of its mission statement. The FAF trustees also determined to revise the FASB's voting procedures to require, beginning in 1991, a supermajority requirement to adopt or amend a standard. Commission staff review of previously adopted FASB standards and an analysis of the public comments on the proposed changes indicate that, while it has not been established that the supermajority voting requirement will lead to an improved perception of FASB standards, the change in procedure should not itself undermine the FASB's ability to set reasonable and effective standards or significantly affect the timing of

their adoption. The Commission will continue its active oversight and monitor the effects of the FAF's action on the FASB's independence and on future accounting standards.

Oversight of the Accounting Profession's Initiatives

In addition to oversight of the private sector process of setting accounting standards, the Commission also oversees the process for setting auditing standards and various other activities of the accounting profession.

AICPA

The AICPA conducts a number of activities that are overseen by the Commission. These include: the Auditing Standards Board (ASB), which establishes generally accepted auditing standards; the AcSEC, which provides guidance on specific industry practices through its issuance of statements of position and practice bulletins and prepares issue papers on accounting topics for consideration by the FASB; and the SEC Practice Section (SECPS), which seeks to improve the quality of audit practice by member accounting firms that audit public companies through various requirements, including peer review.

ASB

The Commission continues to actively oversee the ASB's efforts to enhance the effectiveness of the audit process. The Commission staff is monitoring projects on (1) communications with management and the audit committee when an auditor believes that unaudited interim financial information is probably materially misstated,[244] (2) the use of confirmations and internal auditors, and (3) audit report language

when there is substantial doubt about an entity's ability to continue as a going concern.[245]

The ASB is planning to continue its procedure—initially suggested by the Commission's Chief Accountant—of issuing Audit Risk Alerts to provide auditors with an overview of recent economic, professional and regulatory developments that may affect audits they perform, thereby enabling the AICPA to play a more visible role in focusing auditor attention on high risk areas. A second series of annual Audit Risk Alerts is planned for issuance in time for use as an aid in performing 1990 year-end audits.

SECPS

During fiscal year 1990, the AICPA took steps to expand the membership of the SECPS and to identify and address in a timely fashion any quality control deficiencies in member firms. The Commission exercises oversight of the SECPS through frequent contact with the Public Oversight Board (FOB) and members of the executive and peer review committees of the SECPS. In addition, the staff reviews POB files and selected working papers of the peer reviewers. This oversight has shown that the peer review process contributes significantly to improving the quality control systems of member firms and, therefore, enhances the consistency and quality of practice before the Commission. The SECPS, through its Quality Control Inquiry Committee (QCIC), also reviews and makes inquiries regarding the quality control implications of alleged audit failures involving public clients of SECPS member firms. The staff of the Office of the Chief Accountant has noted significant improvements in the quality of the documentation provided to it by the QCIC. This improved documentation, along with discussions with the POB, allows the staff to better understand the QCIC process. The Commission believes that the process provides added assurances,

as a supplement to the SECPS peer review program, that major quality control deficiencies, if any, are identified and addressed in a more timely fashion. Therefore, the Commission believes that the QCIC process benefits the public interest. The Commission understands that additional improvements are being implemented, such as more frequent review of other work of the engagement teams involved in matters reported to the QCIC and better documentation of the POB's oversight of QCIC. The Commission believes that ongoing improvements such as these will provide even greater assurance of the efficacy of the QCIC process.

AcSEC

The AcSEC has *a* key role in identifying accounting practices, particularly those that impact specialized industries, such as financial institutions, health care, and computer software. During fiscal year 1990, for example, the AcSEC issued a practice bulletin to provide criteria consistent with an earlier Commission interpretive position in Financial Reporting Release No. 28[246] for determining whether collateral for a loan has been in-substance foreclosed.[247]

International Accounting and Auditing Standards

Significant differences in accounting and auditing standards currently exist between countries. These differences serve as an impediment to multinational offerings of securities. The Commission, in cooperation with other members of the International Organization of Securities Commissions (IOSCO), actively participated in initiatives by international bodies of professional accountants to establish appropriate international standards that might be considered for use in multinational offerings. For example, the Commission staff worked with the International Accounting Standards Committee (IASC), a body of accountants with membership in 71 countries, to reduce

accounting alternatives as an initial movement toward appropriate international accounting standards. In 1990, the IASC decided that a substantial number of alternative treatments should be eliminated.[248] Issues of completeness, lack of specificity, and adequate disclosure requirements in international accounting standards still need to be addressed, and the IASC has commenced projects in these areas.

The Commission staff also continued working with the International Federation of Accountants (IFAC) to revise international auditing guidelines. Auditors in different countries are subject to different independence standards, perform different procedures, gather varying amounts of evidence to support their conclusions, and report the results of their work differently. The Commission staff, as part of an IOSCO working group, worked closely with IFAC to expand and revise international auditing guidelines to narrow these differences, and significant progress was made. For example, in October 1990 IFAC revised International Auditing Guideline No. 12 to require the performance of analytical review procedures in the planning phase of an audit and as an overall review at the final stage of the audit.

Independence

The Commission staff is studying the various national and international requirements for auditor independence. In this connection, the staff has received a detailed information about the nature and extent of such requirements in a number of major countries. IFAC issued a set of guidelines to be used by national standard-setters in developing independence requirements. Also, at the staff's request, IFAC agreed to undertake a project to develop a set of specific independence requirements that would apply to auditors of transnational issuers.

The staff is conducting a broad review of the Commission's own auditor independence requirements. This review was prompted by three factors: (1) the increasing globalization of the capital markets; (2) the changes in the size and structure of certain accounting firms during the past decade; and (3) a petition filed I by the largest accounting firms seeking a reconsideration of the Commission's views regarding the ability of accounting firms to engage in prime and subcontractor relationships with registrants that the firms concurrently audit. The staff review is expected to be completed in fiscal year 1991.

THE EDGAR PROJECT

The primary purpose of the Electronic Data Gathering, Analysis, and Retrieval (EDGAR) system is to increase the efficiency and fairness of the securities markets for the benefit of investors, securities issuers, and the economy. Under EDGAR, information currently submitted to the Commission on paper will be transmitted and stored electronically using electronic communication and data management systems. Once the electronic filing is accepted, public information will be available quickly to investors, the media, and others on computer screens via the Commission's public reference rooms and through electronic subscription services. When fully operational, EDGAR will accelerate dramatically the filing, processing, dissemination, and analysis of time-sensitive corporate information filed with the Commission.

Key 1990 Results

The EDGAR pilot system completed its sixth full year of successful operation on September 24, 1990. It has demonstrated clearly the feasibility of receiving, processing, storing, and retrieving electronic filings. Since the pilot's beginning, over 77,364 filings have been transmitted electronically to the Commission.

The Commission also continued with development of the operational EDGAR system. Among the many important milestones achieved during fiscal year 1990 were:

- substantial progress on designing and programming all portions of the operational system;

- delivering 477 workstations to staff users;

- installing the local area network connecting the users' workstations and providing services such as electronic mail;

- constructing an on-site training room and commencing with staff training;

- constructing the first of two computer rooms and installation of the primary hardware and operating software for the operational system;

- convening two public meetings (November 1989 and June 1990) for filers and other persons interested in the status of operational EDGAR;

- negotiating a cost-reimbursement, no fee subcontract between BDM and Bechtel Information Services for Commission microfiche and paper reproduction services; and

- executing a no-cost subcontract between BDM and CompuServe to provide a broad range of electronic mail and bulletin board services.

Pilot System

The EDGAR pilot serves a group of volunteer companies whose filings are processed by staff in the Office of Applications and Reports Services and Divisions of Corporation Finance and Investment Management. At the end of fiscal year 1990, 603 registrants had participated fully in the pilot. In addition, numerous other registrants

had participated partially in the pilot by submitting electronic filings of certain forms. This group of partial participants included:

- 1,104 investment companies submitting annual and semi-annual reports on Form N-SAR;

- 75 registered public utility holding company systems or subsidiaries submitting forms required under the Public Utility Holding Company Act; and

- 16 institutional investment managers submitting Form 13F-E to report securities held in their managed accounts.

No enhancements have been or will be added to the EDGAR pilot since the award of the operational system contract. The pilot system serves solely to permit the already participating volunteer filers to continue to file and the staff to access filings until the operational system is available in 1991. If the conversion to the operational system is successful, the EDGAR pilot will not receive additional filings after September 1991. However, the SEC will not dismantle the pilot until the end of calendar 1991 in order to allow time for the transfer of data to the operational system.

Operational System

The Commission is in the second year of an eight-year contract to design, implement, and operate the EDGAR system. The Commission's current obligation is approximately $63 million over the eight-year life of the contract; however, as with any major development project of this size, it is reasonable to expect that the total costs may increase prior to completion.

During 1990, the Commission and the contractors made substantial progress on the design, programming, and implementation of the operational system. A two-day critical design review of the entire system took place in January 1990 at which certain major issues were resolved and other issues were identified for later review and resolution. With the assistance of several work groups comprised of representatives from the divisions and offices affected by EDGAR, the Office of EDGAR Management satisfactorily resolved almost all issues. Any remaining major issues will be resolved early in fiscal year 1991. Regrettably, the resolution of some of these issues impacted the basic design of EDGAR so the resulting changes took more time and resources than anticipated. This and other factors have delayed by approximately 14 months the projected conversion of the pilot filers to the operational system. These same factors have delayed by approximately 20 months the phase-in of the first group of mandated filers. It is expected that testing of the operational system by pilot filers will begin in February 1991, and live filing will begin in August 1991.

The first visible fruits of the operational system were seen by Commission staff as the first workstations, including both new furniture and computer equipment, were delivered in October 1989 with a total of 477 delivered by September 1990. In November 1989, the first training classes were held in the newly constructed training room. A total of 175 classes were held and attended by 1,100 students. The curriculum included classes on the OS/2 operating system, Presentation Manager, WordPerfect (word processing), EXCEL (spreadsheet), cc:Mail (electronic mail), and use of the local area network (LAN). The LAN was implemented in the spring of 1990 and connected to the EDGAR workstations thereby providing access to electronic mail and other services.

BDM also completed construction of the first of the two computer rooms and installation of two of four Stratus fault-tolerant computers necessary for the operational system.

Continuing its long-standing concern for the public interest in the EDGAR system, the Commission staff convened public meetings in November 1989 and June 1990 for filers, financial printers, and other persons interested in the status of operational EDGAR. Nearly 300 people attended the meetings.

At the end of fiscal year 1990, BDM on behalf of the SEC completed two additional significant subcontracts. The first is with Bechtel, already a subcontractor, and requires that Bechtel provide all Commission microfiche and paper reproduction requirements for both paper and electronic filings received by the Commission. The financial terms of the subcontract are cost-reimbursement with no fee. The second subcontract is with CompuServe and requires that CompuServe provide a broad range of electronic and bulletin board services for communication between the Commission and filers. The subcontract is at no-cost to the Commission.

Rulemaking

The Rulemaking Coordination Work Group has identified issues that require Commission rulemaking, including, among others: (1) phase-in (including voluntary filings); (2) hardship exemptions; (3) filing date adjustments; (4) fee verification; (5) financial data tagging; (6) Williams Act filings; (7) signatures, filer identification and password access; (8) correspondence filed electronically; (9) hours for receipt and acceptance of filings; (10) exhibit files; (11) modular documents (formerly called reference filings); (12) graphic and image material; (13) annual reports to security-holders; (14) amendments; and (15) confidential treatment requests. The initial rules and phase-in

schedule are expected to be released for comment during the first quarter of calendar 1991.

OTHER LITIGATION AND LEGAL ACTIVITIES

The General Counsel represents the Commission in all litigation in the United States Supreme Court, the courts of appeals and the district courts. This litigation includes appeals of district court decisions in Commission injunctive actions and petitions for review of Commission orders. The General Counsel defends the Commission and its employees when sued, prosecutes administrative disciplinary proceedings against securities professionals, and appears amicus curiae on behalf of the Commission in significant private litigation involving the federal securities laws. In addition, under the supervision and direction of the General Counsel, the regional offices represent the Commission in corporate reorganization cases under the Bankruptcy Code that have a substantial public investor interest. The General Counsel also analyzes legislation that would amend the federal securities laws or otherwise affect the Commission's work and prepares legislative comments and congressional testimony. The General Counsel's Office reviews proposed Commission action to ensure that enforcement and regulatory programs are consistent with the Commission's statutory authority. In addition, the General Counsel advises the Commission in the rendering of its decisions in administrative proceedings under various statutes.

Key 1990 Results

The General Counsel represented the Commission in numerous litigated cases in fiscal year 1990. These included 29 appeals before the Supreme Court and the United States courts of appeals. Of these, the Commission received adverse rulings in only seven. There were

also 42 cases in the United States district courts, bankruptcy courts, and administrative tribunals. The Commission prevailed in all of the 22 actions brought in district court against the Commission. The General Counsel also was successful in each of the 10 matters it litigated on behalf of the Commission in the bankruptcy court.

[table omitted]

In addition to litigation, the General Counsel is involved in significant legislative and counseling work. Fiscal year 1990 was characterized by an unusually full legislative agenda for the Commission. In the legislative area, the General Counsel drafted and helped to secure passage of amendments to the securities laws that dramatically strengthen the Commission's enforcement remedies. The office also drafted legislation that enables the Commission to cooperate more effectively with foreign securities authorities, thereby facilitating enforcement of the securities laws in the context of increasingly global markets. The General Counsel drafted provisions of the Market Reform Act, which enhances the Commission's ability to monitor activities that may have significant market impact and permits it to take more effective action in market emergencies. The General Counsel also prepared congressional testimony on a wide range of topics, including accounting reform and the regulation of financial institutions.

Another area in which the office has been significantly involved is the Commission's Emerging Markets Advisory Committee. The Committee, which is comprised of leading executives from brokerage firms, stock exchanges and other institutions, advises the Commission in its efforts to assist other countries with developing securities markets.

Litigation

Insider Trading

In *United States v. Chestman,*[249] an appeal of insider trading criminal convictions, the Commission filed an *amicus curiae* brief urging the United States Court of Appeals for the Second Circuit, sitting *en banc,* to reject the reasoning of a prior panel decision overturning Chestman's convictions for violating Section 10(b), Rule 10b-5, Section 14(e), and Rule 14e-3 of the Securities Exchange Act of 1934 (Exchange Act).

The panel majority had reasoned that Rule 14e-3 is invalid to the extent that it prohibits conduct that does not involve a breach of duty. The majority came to this conclusion by interpreting Section 14(e)'s grant of rulemaking authority to the Commission in light of cases construing, among other things, the Commission's rulemaking authority under Section 10(b). The Commission's brief argued, however, that the Commission's rulemaking authority under Section 14(e) is broader than its authority under Section 10(b). As to the Rule 10b-5 convictions, the Commission's brief argued that the panel erred in requiring that a tippee have specific knowledge that nonpublic information was passed along in breach of a confidential relationship. Instead, the Commission argued that just as a person who has committed the common law crime of receiving stolen property need not know the victim, the circumstances of the theft, or the actual thief, it is sufficient to show that the tippee knew or believed that the information was obtained or being conveyed in breach of some duty. The Commission's brief also argued that the panel erred in requiring an express acceptance of confidentiality by the tipper. Rather, the Commission's brief took the position that an acceptance of such a

duty can be implied from the circumstances surrounding the relationship—in this case, a familial relationship.

In *SEC v. Clark,*[250] the United States Court of Appeals for the Ninth Circuit affirmed a judgment in favor of the Commission based on the "misappropriation" theory of insider trading, a matter of first impression in that Court. The Court held that a person who trades on material nonpublic information, deceitfully stolen or "misappropriated" in breach of a duty, violates Exchange Act Section 10(b) and Rule 10b-5. Clark was found by a jury to have stolen confidential information from his employer about its corporate acquisition plans and to have used that information to reap profits by buying stock of the target company in the securities market. The Court of Appeals held that a fraud occurs where an employee steals and uses his employer's material, nonpublic information despite his implicit representation to his employer not to do so. Agreeing with the Commission, the Court also held, on an issue of first impression, that Clark could be ordered to disgorge profits made by a person he tipped even though that person was found not to have violated Exchange Act antifraud provisions in his trading.

In *SEC v. Unifund SAL,*[251] the United States Court of Appeals for the Second Circuit affirmed, with modifications, portions of preliminary injunctions obtained by the Commission that froze assets held in the defendants' brokerage accounts, but the Court vacated those portions of the injunctions prohibiting future violations of the federal securities laws. In an action filed just two days after the public announcement of a merger, the Commission alleged that the defendants, foreign citizens residing overseas, had engaged in massive illegal trading in the securities of one of the companies to the merger just before the public announcement. The Commission obtained preliminary injunctions, pending further discovery, against two of the defendants based largely on the suspicious pattern of

trading in the accounts. On appeal, the Court rejected the defendants' contention that the Commission was required to make a “strong prima facie case” to obtain preliminary relief and, instead, held that the Commission need establish no more than a likelihood of success on the merits and need not establish irreparable injury as must a private litigant. Although the Court determined that, under this standard, the Commission was not entitled to an interim prohibition against future securities law violations, it affirmed, with modifications, the district court's grant of the freeze orders. The Court allowed the freeze of assets in an amount exceeding the profits to secure not only a potential judgment of disgorgement but also for civil penalties. The Court limited the duration of the freeze order, however, in light of what it viewed as the weak evidence relating to the violation and the hardship to the defendants. The Court noted that in future cases courts should assess all relevant circumstances to determine the coverage, terms, and duration of such orders.

Definition of a Security

As the Commission urged in an *amicus curiae* brief in *Reves v. Ernst & Young,*[252] the Supreme Court reversed a decision by the United States Court of Appeals for the Eighth Circuit and held that interest-bearing demand notes that were widely offered and sold to the public by an Arkansas farmers' cooperative are securities. In so doing, the Court, as the Commission had urged, rejected application of the investment contract test set forth in *SEC v. W.J. Howey Co.*[253] to notes and adopted instead the “family resemblance” approach for determining whether a note is a security. Under this approach, a note with a maturity of greater than nine months is presumed to be a security unless it bears a strong resemblance to certain judicially enumerated instruments that are outside the “investment market” regulated by the federal securities laws (such as notes issued in consumer financing and notes secured by home mortgages).

A majority of the Court also held, as the Commission had urged, that the notes in this case did not fall within the exclusion in Exchange Act Section 3(a)(10) from the definition of security for notes having a maturity “not exceeding nine months.” The Court stated that the maturity of a note payable on demand is ambiguous, since it can be argued that the note matures either at the time of issuance or at the time demand is actually made, which may be later than nine months from issuance. Accordingly, the Court, relying on Congress's broad purpose of “ensuring that investments of all descriptions be regulated to prevent fraud and abuse,” resolved the ambiguity in favor of investor protection.

Liability in Private Actions

The Commission continued to participate in cases raising the issue of the appropriate statute of limitations for private actions under Exchange Act Section 10(b). In *Ceres Partners v. GEL Associates,*[254] the Commission, as *amicus curiae,* successfully urged the United States Court of Appeals for the Second Circuit to abandon its traditional approach of looking to state law limitations periods to limit claims under Section 10(b) in favor of a uniform limitations period drawn from federal law. The Court disagreed with the Commission, however, as to what federal limitations period should govern. The Commission had taken the position that the five-year period in Exchange Act Section 20A enacted in 1988—which codifies an express private right of action for certain violations of Section 10(b) in the nature of insider trading-should be used. The Court instead chose another period governing certain express causes of action under the federal securities laws—one year from discovery of the facts constituting the violation and in no event more than three years from the violation.

In *Ceres,* the Commission advanced the same position as to the appropriate statute of limitations as had the Solicitor General, acting on the Commission's behalf, in an *amicus curiae* brief expressing the view that certiorari should not be granted in *Lebman v. Aktiebolaget Electrolux.*[255] Later, the Solicitor General, on behalf of the Commission, filed a brief *amicus curiae* on the merits in *Lampf Pleva Lipkind Prupis & Petigrow v. Gilbertson,*[256] again advocating the adoption of Section 20A's five-year period.

In *Mendell v. Gollust,*[257] the United States Court of Appeals for the Second Circuit, in an opinion reflecting the position urged by the Commission in a brief filed at the Court's request, held that a plaintiff may maintain a suit under Exchange Act Section 16(b) on behalf of the issuer, to recover short-swing profits allegedly obtained by the issuer's insiders in transactions involving the issuer's stock, even after the plaintiff is involuntarily divested of his own shares of the issuer. The plaintiff in this case owned common stock of the issuer at the time of the defendant's short-swing transactions and at the time he filed suit, but was subsequently divested of his shares as a result of a merger. The Commission argued, and the Court agreed, that the remedial and deterrent purposes of Section 16(b) would be undercut if a shareholder was deemed to lose his standing to sue by being involuntarily divested of his shares through a business combination such as a merger.

Broker-Dealers and Market Professionals

In *Hollinger v. Titan Capital Corp.,*[258] the United States Court of Appeals for the Ninth Circuit, sitting *en banc,* issued an important opinion in the area of broker-dealer regulation, agreeing with the positions urged by the Commission as *amicus curiae,* and overriding numerous of the Court's precedents. First, the Court held that under Exchange Act Section 20(a), which makes a broker-dealer firm liable

for the fraud of persons it controls unless it can establish a “good faith” defense, a firm is always a “controlling person” of salespersons who are associated with it. Second, the Court decided that the firm cannot avoid its duty to supervise persons it controls merely because those persons are independent contractors. Third, the Court held that a plaintiff in a Section 20(a) case need not plead and prove that the firm was a “culpable participant” in the violation committed by the controlled person. Fourth, the Court held that the burden of proof in establishing the good faith defense under Section 20(a) rests on the firm. A firm cannot satisfy that burden simply by showing that it has a system of supervisory procedures in place; it must persuade the court that the supervisory system is adequate and that the firm in fact reasonably discharged its obligation of enforcing the system.

Finally, the Court held that controlling person liability does not supplant strict liability under the federal securities laws based on the common law principle of respondeat superior; under the latter doctrine, the firm is vicariously liable for the damages caused by the fraudulent conduct of its agents and employees. In one respect, the Court did not follow the Commission's position. For purposes of defining “recklessness” which will satisfy the scienter requirement of Section 10(b) and Rule 10b-5, the Court adopted a different standard of recklessness than the common law fraud standard of “conscious indifference,” which the Commission had advocated.

Self-Regulatory Organizations

In *The Business Roundtable v. SEC,*[259] the United States Court of Appeals for the District of Columbia Circuit vacated Exchange Act Rule 19c-4, regarding shareholder voting rights. That rule amended the rules of national securities exchanges and associations to prohibit the listing or quoting of equity securities of any company that nullifies, restricts, or reduces the per share voting rights of any outstanding

class of common stock. The Court held that the rule was beyond the Commission's authority and impermissibly infringed upon the states' traditional authority to charter and regulate corporations. The Commission had centered its discussion of its authority to promulgate the rule on furthering the objective of Exchange Act Section 14(a) of ensuring fair corporate suffrage. The Court decided in effect, however, that the purpose of Section 14(a) was limited to improving shareholder communication. A broader reading of the rule would, according to the Court, permit the Commission to establish an entire body of federal corporate law. The Court also rejected the Commission's argument that other sources of authority, including the 1975 amendments to the securities laws, served to support the adoption of the rule.

In *Board of Trade of the City of Chicago v. SEC,*[260] two futures exchanges petitioned for review of (1) a 1989 Commission order granting Delta Government Options Corporation (Delta) temporary registration as a clearing agency and (2) a no-action letter issued by the Commission's Division of Market Regulation stating that the division would not recommend enforcement action should certain entities operate the proprietary trading system (the System) of which Delta was a part, without being registered as an exchange under Exchange Act Section 6. As to the 1989 order, the United States Court of Appeals for the Seventh Circuit determined that the Commission's finding in the order that Delta was organized and had the capacity to comply with the Exchange Act was defective for lack of a determination with regard to the status of the System as an exchange. As to the no-action letter, however, the Court agreed with the Commission that under the rationale *of Heckler v. Chaney,*[261] the division's position that it would not recommend enforcement action was not subject to judicial review. The Commission renoticed Delta's application for clearing agency status, and, in 1990, issued another order which granted Delta temporary registration and expressly

determined that the System does not constitute an exchange. The futures exchanges petitioned for review of this order. The Court affirmed,[262] essentially agreeing with the Commission's argument that the Commission's analysis of the “exchange” issue is a reasonable, practicable interpretation of the definition of that term in the Exchange Act, and that the Commission, in making this analysis, was acting consistently with its congressional mandate to interpret and implement the securities laws in an ever-changing, technologically innovative environment. Rehearing was denied.

International Application of the Securities Laws

SEC v. International Swiss Investments Corp.,[263] concerned a boiler room operated by persons in various Latin American countries using the telephone to sell securities to U.S. residents. The Commission brought an action alleging violations of the federal securities laws and served its complaint by hand in Mexico. As urged by the Commission, the United States Court of Appeals for the Ninth Circuit rejected the defendants' challenge to the service of process. First, the Court held that the Commission was not required to serve process on the defendants through the Inter-American Convention on Letters Rogatory since the convention had not been ratified by the Senate at the time that service was made. Second, the Court determined that the Commission complied with Rule 4 of the Federal Rules of Civil Procedure and that the manner of service did not violate international law.

Actions Involving Other Agencies

The Solicitor General filed a brief on behalf of the Federal Energy Regulatory Commission (FERC) as respondent and the Commission as *amicus curiae* in *Arcadia, Ohio v. Ohio Power Company,*[264] a case involving the circumstances under which SEC regulation under the

Public Utility Holding Company Act (Holding Company Act) precludes FERC regulation under the Federal Power Act (FPA). Specifically, the case raised the question whether Section 318 of the FPA, which governs “conflict of jurisdiction” between FERC and the Commission, precludes FERC jurisdiction whenever FERC and the Commission have jurisdiction to regulate the same subject matter, or only when there is an actual conflict between a requirement of FERC and a requirement of the Commission. The brief filed on behalf of FERC and the Commission took the position that Section 318's rule of precedence takes effect only when regulations or orders adopted under the Holding Company Act and the FPA created conflicting obligations for regulated entities. The brief did not address whether there was an actual conflict in this case.

In its decision, the Supreme Court concluded that Section 318 had no application to this case. The Court interpreted Section 318 literally to limit the section's application to circumstances where the subject matter in issue falls within four enumerated categories set forth in Section 318. In the Court's view, it was not possible to identify any FERC requirement in this case falling within these categories.
In *FDIC v. Jenkins*,[265] the United States Court of Appeals for the Eleventh Circuit, agreeing with the arguments made by the Commission as amicus curiae, reversed a district court injunction prohibiting shareholders of a bank holding company from satisfying their Rule 10b-5 claims against certain third parties from those parties' assets until the Federal Deposit Insurance Corporation's (FDIC) claims against the same parties are satisfied. The Court agreed with the Commission that the absolute priority rule (which requires in certain contexts that creditors' claims against a corporation receive priority over the claims of its shareholders) applies only to claims against an insolvent entity's assets and not, as the FDIC asserted, to assets of third parties. Turning to issues not addressed by the Commission, the Court further held that an absolute

priority was not "implicit" in the Federal Deposit Insurance Act and was unnecessary for the FDIC to fulfill its statutory duties.

Actions Involving the Proxy Antifraud Provisions

In *Virginia Bankshares, Inc. v. Sandberg*,[266] the Solicitor General filed an amicus curiae brief in the Supreme Court on behalf of the Commission and the FDIC addressing issues of materiality and causation under the proxy antifraud provisions of the Exchange Act. These two consolidated private damage actions arose from a "freeze-out" merger in which the plaintiffs' shares were converted into a right to receive a certain amount of cash. The plaintiffs alleged that the proxy statement issued in connection with the merger was materially false and misleading, in violation of Exchange Act Section 14 and an antifraud rule thereunder. The plaintiffs obtained a jury verdict, -which was affirmed by the Court of Appeals. In the Supreme Court, the defendants argued that, as a matter of law, they could not be liable for the types of misstatements alleged. The first issue they raised was •whether representations in a proxy statement concerning directors' reasons and purposes for recommending approval of a particular transaction, and their characterizations of matters discussed in the statement, by words such as "independent," can be materially false or misleading. The government's brief argued that such misrepresentations can be actionable. The second issue was whether minority shareholders can establish that their injuries were caused by a false or misleading proxy statement when they lacked sufficient votes to block the transaction on which the vote was taken. The government's brief argued that causation may be established where minority shareholders are misled into voting in favor of a transaction, thereby losing an appraisal remedy under state law, or where minority shareholders have, by a false or misleading proxy statement, been prevented from employing a variety of other methods to alter the transaction's terms.

Litigation Involving Requests for Access to Commission Records

The Commission received approximately 2,000 requests under the Freedom of Information Act (FOIA) for access to Commission records and approximately 3,200 requests for confidential treatment from persons who submitted information. There were 61 appeals to the Commission's General Counsel from initial denials by the FOIA Office of FOIA requests, and 11 appeals of denials of confidential treatment requests. Only two requests resulted in court actions against the Commission.

One of the two court actions arose out of the Commission's denial of a confidential treatment request.[267] However, after the Commission filed a motion for summary judgment, the requester voluntarily dismissed the case. In the second,[268] the district court upheld, in all material respects, the Commission's denial of access to documents from numerous investigative files. The unsuccessful requester appealed that decision to the United States Court of Appeals for the District of Columbia Circuit. The Commission has filed its brief urging the Court to uphold the district court's finding that personal information in trading records, account statements, and other records provided to the Commission during the investigations are protected from release by FOIA Exemption 7(C), which exempts from disclosure information, the release of which may result in an invasion of personal privacy. The brief also argues that minutes of closed Commission meetings are not “final agency decisions” as defined by the FOIA. The Court of Appeals for the District of Columbia Circuit has heard oral argument and the case is under submission.

The Office of General Counsel also handled 117 subpoenas served by parties in private litigation seeking Commission documents or investigative testimony. A number of the subpoenas sought

documents from active investigations which the Commission declined to produce on grounds of the governmental law enforcement privilege, as their release could impair ongoing proceedings. As a result, certain of these subpoenas led to motions to compel, or Commission motions for protective orders. The Commission was successful in each of these litigated motions.

Actions Under the Right to Financial Privacy Act

Eight actions were filed against the Commission under the Right to Financial Privacy Act (RFPA), to block Commission subpoenas for customer information from financial institutions.[269] One action was dismissed voluntarily by the movant after the Commission filed its opposition. The remaining actions were dismissed after the court found, in each case, the Commission was seeking the records for a legitimate law enforcement inquiry, and the records were relevant to those investigations.[270] Of particular note is *In Re Securities and Exchange Commission Private Investigation/Application of John Doe re Certain Subpoenas,*[271] in which the District Court for the Southern District of New York made several rulings which should assist the Commission in litigating RFPA challenges. First, the Court reaffirmed, over the movant's objection, the modest burden of proof on the agency in a RFPA case, noting that an agency is not required to demonstrate that the records sought “are” relevant to the investigation, but need only establish “a reasonable belief that the records sought are relevant.” Equally significant, the Court held that the Commission met this burden upon demonstrating that the customer had control over certain brokerage accounts in which suspect trading occurred: “Once a person's connection to apparently illicit conduct has been shown, it is relevant to know whether that person's bank account contains evidence of such conduct." Finally/ the decision makes clear that the length of time covered by

subpoenas to banks challenged under the RFPA need not be limited in scope to the dates of the alleged improper trading.

Actions Under the Equal Access to Justice Act

The office obtained favorable decisions in two actions under the Equal Access to Justice Act. In one, *SEC v. Comserv Corp.*,[272] the United States Court of Appeals for the Eighth Circuit reversed and vacated the district court's award of attorneys' fees and expenses. The district court, after dismissing the Commission's action against one defendant, found that the action was not "substantially justified" and awarded fees, notwithstanding its acknowledgment that the award would not go to the defendant, but to the insurer that provided defendant's liability coverage. As urged by the Commission, the Court of Appeals reversed, holding that the defendant was ineligible to recover under the Act because his insurer was contractually obligated to pay his attorneys' fees.

Actions Against Commission and Staff

Six actions were filed against the Commission and individual staff members seeking monetary damages and/or injunctive relief. The office defended successfully each of these actions. In *Hale v. McKenzie*,[273] plaintiff Joseph H. Hale, who had been prosecuted successfully for violations of the federal securities laws, sued the Commission and three current or former Commission staff members, alleging numerous common law and constitutional violations in connection with the Commission's prosecution of the plaintiff.[274] The United States District Court for the Northern District of Georgia dismissed the plaintiff's unfounded claims against the Commission on the grounds of sovereign immunity, and those against the staff on the grounds of, among other things, official immunity – as the actions of

which he complained were undertaken by the staff as part of their official responsibilities.

Similarly, in *SEC v. American Assurance Underwriter Group, Inc.*,[275] a Commission injunctive action, defendant William A. Calvo, III, filed a counterclaim alleging staff misconduct. The United States District Court for the Southern District of Florida dismissed the claim, finding that it was barred by Section 21 (g) of the Exchange Act, which prohibits the consolidation of Commission injunctive actions with any private action without the Commission's consent.

Motions to Vacate Injunctions

During the last fiscal year, the staff responded to three motions to vacate injunctions. In *SEC v. Belmont Reid and Company*,[276] the United States District Court for the Northern District of California denied a motion to vacate the consent injunction obtained in a Commission enforcement action. In that action, the Commission had alleged that defendants fraudulently sold unregistered securities when they sold contracts for the future delivery of gold coins. Most of the defendants consented to injunctions, but three continued to litigate. The District Court ultimately ruled that the gold coin contracts were not securities.[277] In their motion to vacate, nine of the consenting defendants argued that, because the District Court had ruled that the gold coin contracts were not securities, the consent judgment was void for lack of subject matter jurisdiction and the injunction was unfair. The District Court agreed with the Commission, ruling that it had jurisdiction to enter the consent decree, the motion was untimely, and the injunction did not constitute grievous wrong resulting from unforeseen circumstances such as would justify vacation of the injunction.

Actions Against Professionals Under Commission Rule 2(e)

In the spring of 1990, the Commission organized a new group within its Office of the General Counsel to focus primarily on the litigation of administrative disciplinary cases against professionals under Rule 2(e) of the Commission's Rules of Practice. These cases are often large and complex. The outcome of such cases against accountants may affect how reporting companies account for costs in filings before the Commission. The creation of the new Rule 2(e) group reflects the emphasis the Commission attaches to these important cases. During the year, several Rule 2(e) actions were concluded. In *In re Ernst & Whinney,*[278] Administrative Law Judge Jerome Soffer found that Ernst & Whinney (now Ernst & Young) and one of its partners had engaged in improper professional conduct by violating generally accepted auditing standards during the audit of US Surgical Corporation's 1980 and 1981 financial statements. Judge Soffer found that audit partners “all the way up to the top level including the co-chairman” participated in the outcome of the audit and that the auditors unduly relied upon representations of Surgical management even after serious questions concerning management's integrity were raised during the audit. Based on his findings, Judge Soffer suspended the New York region of the firm from undertaking any new Commission engagement for a period of 45 days. No appeal to the Commission was taken from the ruling.

In *In re Calvo,*[279] Administrative Law Judge Max Regensteiner found that the public interest required attorney William Calvo to be suspended for two years. Calvo had been permanently enjoined from violating antifraud provisions of the federal securities laws in connection with his conduct, among other things, in fraudulently extending a public offering beyond the period specified in the prospectus.[280] No appeal was taken from the ruling.

In *In re Blonquist,*[281] attorney Thomas Blonquist consented to a Commission order under Rule 2(e) suspending his right to practice before the Commission for five years. The suspension was based on a prior Commission action against Blonquist, *SEC v. Thomas™*[2] where the district court found that he had willfully aided and abetted violations of antifraud provisions of the federal securities laws and permanently enjoined Blonquist from further violations.

In *In re Tepps and Goldstein,*[263] attorneys Jerome Tepps and Michael Goldstein consented to a Commission order suspending them from practicing before the Commission for five years. The suspensions were based on a prior Commission action against Tepps and Goldstein[284] in which they were permanently enjoined from violations of antifraud and reporting provisions of the federal securities laws. The action arose from their conduct in preparing certain false and misleading filings disseminated to the public by four blind pool issuers.

Significant Administrative Decisions

Broker-Dealers and Market Professionals

In *F.J. Kaufman &Co. of Virginia and Frederick J. Kaufman, Jr.*,[285] the Commission affirmed disciplinary action taken by the NASD against a former member firm and its general partner for violating the NASD's suitability rule. The Commission found, as had the NASD, that Frederick Kaufman devised and recommended to three sets of customers an options program, generally known as the "margined buy-write strategy." Under Kaufman's plan, customers sold call options and used the premiums, together with other available funds, to purchase shares of the underlying stock on margin. However, the Commission found that, when transaction costs were taken into account, Kaufman's strategy was always inferior to a straight

purchase of the same stock, either for cash or on margin. Thus, the Commission concluded that Kaufman's strategy was not suitable for any investor, a fact of which Kaufman should have been aware.

In *Investors Portfolio Management, Inc. (IPM)*,[286] the Commission revoked the investment adviser registration of IPM, the adviser to a municipal bond fund. IPM developed a program pursuant to which the fund bought municipal bonds in odd lots and with "short settlement" dates (less than five business days after the date of purchase). Its objective was to acquire bonds for the fund's portfolio that would not be delivered by the settlement date, thereby becoming so-called "failed bonds." Failed bonds accrue interest from the settlement date even though they need not be paid for until they are delivered. Thus, when a bond "failed," the fund collected interest until the date of delivery without any expenditure of capital. Moreover, in the interim, IPM used the money that the fund would have paid out for the failed bonds to purchase additional bonds for the fund. In this way, the fund was able to collect two payments of interest on the same money. This practice produced deceptively high temporary yield rates, and caused the fund to borrow beyond its authorized ceiling when a large number of failed bonds were delivered at the same time and the fund had to pay for them.

The Commission found that IPM violated antifraud provisions by advertising the fund's high yields without disclosing that they were merely temporary, and the Investment Company Act by causing the fund to exceed its borrowing limit.

Significant Legislative Developments

Enforcement Remedies

On October 15,1990, the President signed into law the Securities Enforcement Remedies and Penny Stock Reform Act of 1990.287 This legislation, which substantially increases the strength and flexibility of the Commission's enforcement remedies, was based upon a Commission proposal submitted to Congress in January 1987 and introduced in the 101st Congress by Senators Dodd and Heinz and Congressman Dingell. In February 1990, Chairman Breeden testified before the Subcommittee on Securities of the Senate Committee on Banking, Housing and Urban Affairs, recommending a number of changes to the legislation that were largely incorporated into the final bill.

Provisions of the Act relating to penny stocks are based on H.R. 4497, the Penny Stock Reform Act of 1990, which was introduced by Congressman Markey in April 1990. Chairman Breeden testified on April 25 before the Subcommittee on Telecommunications and Finance of the House Committee on Energy and Commerce concerning these provisions.

The Act authorizes the Commission to seek civil money penalties (in addition to disgorgement orders) in district court actions, and to impose money penalties in administrative proceedings brought against broker-dealers, investment advisers, and other regulated entities. In addition to penalties, the Commission is expressly authorized to enter an order requiring an accounting and disgorgement, including reasonable interest.

The legislation also includes provisions, first requested by Chairman Breeden in his February 1, 1990 testimony before the Senate Securities Subcommittee, that authorize the Commission (following notice and opportunity for a hearing) to issue cease and desist orders to enforce the requirements of the Securities Act of 1933 (Securities Act), the Exchange Act, the Investment Company Act, and the

Investment Advisers Act. The Commission also is empowered to order a respondent to disgorge profits resulting from a violation or to take affirmative steps to ensure compliance with the law. The Commission may not, however, impose civil penalties in a cease and desist proceeding. Commission orders in cease and desist proceedings are enforceable in federal district court and are subject to review by the courts of appeals.

The Act expressly authorizes district courts to suspend or bar a defendant in a Commission action from serving as an officer or director of a reporting company. This express authority is limited to defendants who are found to have violated Section 17(a)(l) of the Securities Actor Section 10(b) of the Exchange Act. The court also must find that the defendant's conduct demonstrates “substantial unfitness” to serve as an officer or director.

With regard to penny stock reform, the Act contains a definition of penny stocks as equity securities that do not fall within one of several excluded categories *(e.g.,* securities traded on a national securities exchange or quoted on NASDAQ). The Commission has broad authority to exclude additional securities or classes of securities. The Commission's sanctioning authority is expanded to enable it to bar persons from “participating in an offering of penny stock.”

Market Reform

Following the October 1987 market break, the Commission submitted to Congress a number of legislative proposals that were designed to increase its ability to monitor activities that may have significant market impact and to take effective action in market emergencies. After some amendments to the Commission's proposals, the House and Senate passed the Market Reform Act of 1990[288] in September. The legislation was signed by the President on October 16, 1990.

The Act authorizes the Commission to suspend trading for up to 90 days if the Commission deems it to be required in the public interest and for the protection of investors. Before using this authority, the Commission must notify the President and determine that he does not disapprove.

The Commission also is authorized to adopt rules that prescribe means reasonably designed to prevent the manipulation of price levels of the equity securities market or a substantial segment of that market, and that prohibit, during periods of extreme market volatility, any trading practice that the Commission has found to contribute significantly to extraordinary levels of volatility threatening the maintenance of fair and orderly markets.

Two new provisions enhance the Commission's ability to monitor the securities markets. First, large traders may be required to provide information to the Commission concerning their identity and the accounts through which they effect transactions. Moreover, broker-dealers must maintain in their files and make available to the Commission information concerning large traders and large transactions. The second provision authorizes the Commission to require broker-dealers to obtain information and keep records concerning their procedures for monitoring and controlling financial and operational risks resulting from the activities of any of their associated persons (other than natural persons). The Commission may require that summary reports be filed with it and may obtain immediate and more detailed risk assessment information if it reasonably concludes that it has concerns regarding the financial or operational condition of the broker-dealer.

The Act directs the Commission to undertake a number of initiatives in the area of clearance and settlement, including the establishment of a federal advisory committee to assess the adequacy of state

commercial laws, and authorizes the Commission, upon making the necessary findings, to adopt rules concerning the transfer and pledge of securities that would preempt state law. Moreover, the Commission is directed to facilitate the establishment of a national system for prompt and accurate securities clearance and settlement, and linked or coordinated facilities for the settlement of transactions in securities, securities options, contracts of sale for future delivery, and options on such contracts and commodity options.

Other Amendments to the Securities Laws

A number of other Commission legislative proposals were enacted during the 101st Congress as the Securities Acts Amendments of 1990.289 Title II of the Act, the International Securities Enforcement Cooperation Act of 1990, substantially improves the Commission's ability to cooperate with the securities regulators of other countries. The amendments exempt certain documents obtained from foreign regulators from the disclosure requirements of the FOIA. They also clarify the Commission's authority to provide foreign and domestic securities officials with nonpublic information and permit the Commission to obtain reimbursement from a foreign authority for expenses incurred in providing assistance to that authority. The Commission and the self-regulatory organizations are permitted to impose sanctions on a securities professional found by a foreign court or securities authority to have engaged in illegal or improper conduct.

Title III of the Act, the Shareholder Communications Improvement Act of 1990, eliminates an unintended gap in the statutory scheme governing communications with shareholders. Section 14(b) of the Exchange Act is amended to extend to mutual funds and other investment companies the benefits of the Commission's shareholder communication rules. These rules, which require entities with

fiduciary responsibilities that hold securities in nominee name to deliver proxy materials and annual reports to beneficial owners and to provide information concerning such beneficial owners to issuers on request, are designed to facilitate communication between investment companies and beneficial owners of investment company securities held in street name. Broker-dealers and bank nominees also are required to transmit information statements to beneficial owners of securities. An issuer subject to the proxy provisions must transmit such statements to shareholders of record when it holds a shareholder vote but does not solicit proxies. The amendments require mutual funds and other investment companies to provide such information statements under similar circumstances.

The Trust Indenture Reform Act of 1990 was enacted as Title IV of the Act. It comprehensively modernizes the Trust Indenture Act of 1939 to accommodate its requirements to the needs of contemporary financing and institutional trust practice without undermining the purposes of the Act. The Trust Indenture Act requires that non-exempt debt issued to the public must be issued under an indenture and imposes certain requirements and limitations on the contract that governs the rights and duties of the issuer, the debtholders, and the indenture trustee. The recent amendments make mandatory indenture terms self-executing through operation of law to make certain that such provisions are part of every indenture qualified under the Act. The Commission's exemptive authority under the Act is broadened, and it is permitted to allow foreign entities to serve as trustees under qualified indentures in certain circumstances. In recognition of modern trust practice, technical conflicts of interests are made irrelevant to a trustee's eligibility prior to a default.

Jurisdictional Proposal

In June 1990, the Department of the Treasury transmitted to Congress an Administration legislative proposal, the Capital Markets Competition, Stability and Fairness Act of 1990. The proposal would have transferred from the Commodity Futures Trading Commission the authority to regulate stock index futures and options on stock index futures by incorporating the Commodity Exchange Act (CEA) into the Securities Exchange Act of 1934 with respect to these products. It also would have subjected the futures exchanges' regulation of margins on stock index futures and options to Securities and Exchange Commission oversight and would have modified the exclusivity clause of the CEA to allow instruments with characteristics of both futures and securities to trade in both commodity and securities markets. The bill would have required the Securities and Exchange Commission to report to Congress on additional modifications necessary for the efficient regulation of the linked markets for stocks, stock options, and stock index futures. The bill was introduced in the House as H.R. 5006 and in the Senate as S. 2814. Neither bill was reported out of committee.

Commission Testimony on Other Issues

The Office of the General Counsel prepared testimony presented on behalf of the Commission on a wide range of issues under the federal securities laws during the second session of the 101st Congress. On August 2, 1990, the General Counsel testified at a hearing before the House Telecommunications and Finance Subcommittee on a draft legislative proposal sponsored by Congressman Wyden. That proposal would have required each issuer to evaluate its internal control structure and disclose the results of such assessments in its annual reports to shareholders, along with a report by an independent public accountant on management's assessment. The bill also specified certain procedures that must be included in any audit of an issuer's financial statements required by the Exchange Act and

required that auditors confidentially report substantial, continuing, or uncorrected illegalities directly to the Commission. Although these provisions were added to the Comprehensive Crime bill by the House (H.R. 5269), the Senate version of the bill did not include similar language. The auditor requirements were not included in the crime bill ultimately agreed to by the Senate and House conferees and enacted into law.

Chairman Breeden also testified on accounting reform. Before the Senate Banking, Housing and Urban Affairs Committee on September 10, 1990, the Chairman stressed that accounting reform, particularly a shift toward market value accounting, is necessary to assure that meaningful financial information reaches the public. Chairman Breeden had testified before the same committee on July 19,1990, supporting a comprehensive reform of the U.S. system for regulating financial institutions. The Commission took the position that Congress should undertake an examination of the impediments to efficient operations of financial institutions and stated that reform is necessary to reduce significantly the aggregate exposure of taxpayers, to introduce market discipline, and to eliminate distortions to competition. Substantially similar testimony was presented by Chairman Breeden on July 11, 1990 before the Subcommittee on Telecommunications and Finance of the House Committee on Energy and Commerce. Chairman Breeden also testified before the House Banking, Finance and Urban Affairs Committee on November 14, 1989 concerning the collapse of Lincoln Savings and Loan and the related bankruptcy of its holding company, American Continental Corporation. He noted that there is an inherent risk of confusion when federally insured depository institutions are permitted to sell uninsured securities to the public from the same offices where insured deposits are accepted and called for legislation to protect unsuspecting investors from potential exploitation.

Corporate *Reorganizations*

The Commission acts in a statutory advisor's role in reorganization cases under Chapter 11 of the Bankruptcy Code to see that the interests of public investors are adequately protected. In these cases a debtor generally is allowed to continue business operations under court protection while it negotiates a plan to rehabilitate the business and to pay the company's debts. Reorganization plans often provide for the issuance of new securities to creditors and shareholders in exchange for part or all of their claims or interests in the debtor, under an exemption in the Bankruptcy Code from registration under the Securities Act.

In fiscal year 1990, the Commission authorized a review of its Section 1109(a) general statutory advisory role in Chapter 11 cases and of the adequacy of public investor protections under Chapter 11 of the Bankruptcy Code. The goal of this review is to provide an informed basis upon which to determine whether that role should be modified and whether legislation is needed. In connection with the review, the Commission has received, in response to a release issued in September 1989,[290] over 40 comments from the bench, bar, and others regarding the issues raised in the release. The project also includes an assessment of active participation by the Commission staff in six reorganization cases, which have been paired with six other cases in which the Commission is not actively participating.

In its capacity as a special advisor, the Commission may raise or present its views on any issue in a Chapter 11 case. Although the Commission may not initiate an appeal, it frequently participates in appeals taken by others. While Chapter 11 relief is available to businesses of all sizes, the Commission generally limits its participation to cases involving debtors that have publicly traded

securities registered under the Exchange Act. In fiscal year 1990, the Commission participated in Chapter 11 cases on a variety of issues.

Committees

Official committees are empowered to negotiate with a debtor in possession on the administration of a case and to participate in all aspects of the case, including formulation of a reorganization plan. With court approval, an official committee is permitted to employ, as a cost of administration, one or more attorneys, accountants, or other professionals to assist the committee in performing its duties. In addition to a committee representing creditors holding unsecured claims, the Bankruptcy Code allows the court or a United States trustee to appoint additional committees for stockholders and others where necessary to assure adequate representation of their interests. During fiscal year 1990, the Commission moved or supported motions for the appointment of committees to represent investors in two Chapter 11 cases.[291]

In a case having practical significance for the representation of equity security-holders by official committees, *In re The Worthington Company,*[292] the Commission filed a memorandum in support of a petition for rehearing in the Court of Appeals for the Sixth Circuit, taking the position that the Bankruptcy Code permits regular reimbursement of actual, necessary expenses of members who serve on official committees. The panel majority, which was the first court of appeals to address this issue, had held that because there is no express provision in the Bankruptcy Code permitting the payment of expenses incurred by members of an official creditors' committee, such expenses cannot be paid from the estate. The Commission, agreeing with the dissenting opinion, urged that the panel majority misinterpreted Section 503(b) of the Code, which gives bankruptcy courts considerable flexibility in deciding which expenses can be paid

from the estate. After the close of the fiscal year, the Sixth Circuit panel, agreeing with the Commission's position, reversed its earlier decision and permitted the payment committee expenses.[293]

Estate Administration

The Commission acts to protect the interests of public investors in reorganization cases by participating on selected issues involving administration of the debtor's estate that have a significant impact upon the rights of public investors.

In *Grogan v. Garner,*[294] in response to the Supreme Court's request for the government's views, the Solicitor General filed an *amicus curiae* brief on behalf of the Commission (and other interested federal departments and agencies) concerning the standard of proof applicable in a proceeding to have a debt that is based on the debtor's fraud excepted from the bankruptcy discharge. The United States Court of Appeals for the Eighth Circuit[295] had held that a clear and convincing evidence standard (rather than the lesser standard of preponderance of the evidence) applied in determining whether such fraud claims can be discharged under Section 523 of the Bankruptcy Code.

The government's brief in the Supreme Court pointed out that the Circuit Court had erroneously based its decision on a presumption that Congress was aware when it enacted Section 523 that the "prevailing view" was that fraud had to be proved by clear and convincing evidence. The brief demonstrated that there was in fact no consistent pre-Code practice of requiring clear and convincing proof either to establish fraud generally or to demonstrate in bankruptcy that a debt was incurred by fraud. In addition, the brief argued that application of the clear and convincing evidence standard would depart from the standard of proof in important federal antifraud

statutes such as the federal securities laws, the False Claims Act, the CEA, the money penalty provisions of the Federal Deposit Insurance Act, and RICO.

Moreover, application of the clear and convincing evidence standard in Section 523 proceedings would mean that fraud victims who have successfully litigated fraud claims under these antifraud statutes would have to litigate their claims again, under a higher standard of proof, in the bankruptcy court. Finally, the brief argued that the "fresh start" policy of the Bankruptcy Code was not inconsistent with applying a lower standard of proof, since an innocent victim's interest in obtaining compensation for fraud is at least as important as the defrauding debtor's interest in obtaining a "fresh start" via the bankruptcy discharge. After the close of the fiscal year, the Supreme Court, agreeing with the government's position, ruled that the preponderance of the evidence standard was applicable under the Section 523 of the Code.[296]

In *In re Resorts International, Inc.*[297] the Commission, relying on In re Baldwin-United, 43 3.R. 443 (S.D. Ohio 1984), filed a brief in the bankruptcy court urging that indemnification of legal defense costs incurred by officers and directors may be authorized as an administrative expense of the estate under Section 503(b)(l)(A) of the Code if the court finds that their continued service is beneficial to the estate and that the benefits to be derived from their continued service justify the amount of advances for legal fees. In this case, because no adequate showing was made, the Bankruptcy Court denied the debtor's request for such indemnification.

In *In re Kaiser Steel Resources*,[236] a case having major significance to the brokerage industry, the Commission, in an appeal to the Tenth Circuit, addressed the issue of liability under fraudulent conveyance laws for payments made in connection with a leveraged buyout.

Kaiser brought an adversary proceeding naming 194 defendants—including financial intromediance such as brokerage firms, banks, and trust companies as well as its former shareholders from whom Kaiser is seeking to recover payments it made in a 1984 leveraged buyout (LBO), on the ground that the transaction was a fraudulent conveyance under California law, and thus is subject to avoidance under the Bankruptcy Code. The Tenth Circuit in a test case involving a discount brokerage firm defendant, held that the LBO payments are securities "settlement payments" protected from avoidance under Section 546(e) of the Code. The Tenth Circuit is now considering whether Section 546(e) applies to the remaining financial intermediaries' defendants and Kaiser's former shareholders.[299] The Commission, in its brief to the Tenth Circuit, argued that Section 546(e) on its face applies to payments made “by or to” a stockbroker, securities clearing agency, or financial institution, and that the Kaiser LBO payments were all made by or to one of these entities. In addition, interpreting Section 546(e) as applying to financial intermediaries and shareholders furthers the important objectives of protecting the integrity of the securities clearance and settlement system and promoting investor confidence in the securities markets.

In *In re General Development Corp.,*[300] the Commission filed a brief addressing the scope of the bankruptcy court's authority to enjoin a Delaware state court action seeking authority to nominate and solicit the election of an alternative slate of candidates for the debtor's board of directors. The regular annual meeting had been scheduled by the company's board of directors after the company filed its Chapter 11 petition. The Commission argued, consistently with the position urged by the Commission and adopted by the Second Circuit in *In re Johns-Manville Corp.,*[301] that shareholders of debtor corporations do not lose their corporate governance rights under state law, unless it is shown that there has been a “clear abuse” of such rights that is likely to jeopardize the reorganization. The

bankruptcy court, agreeing with the Commission's position, concluded that the record did not support a finding of clear abuse and allowed the Delaware action to continue.

During fiscal year 1990, the Commission reiterated its position (55th Annual Report at 84-85, 54th Annual Report at 96, and 53rd Annual Report at 73) that class claims are permissible in bankruptcy. The Commission believes that, under principles of statutory construction, the well-recognized right to file class claims outside of bankruptcy is equally available in bankruptcy cases. In *In re LTV Corp.,*[302] the Commission filed a brief in the Second Circuit reiterating its view that class claims are permissible in bankruptcy. In this case, the district court, relying on *The American Reserve*[303] and *The Charter Co.*[304] circuit court decisions, concluded that permitting proofs of claim to be filed on behalf of a class is consistent with the broad goals of the Bankruptcy Code.

In reversing the bankruptcy judge's decision, the court rejected a much-cited 1985 decision to the contrary in *In re Johns-Manville,*[305] *by* the Chief Judge of the Bankruptcy Court for the Southern District of New York. The appeal is pending.

Disclosure Statements/Plans of Reorganization

A disclosure statement is a combination proxy and offering statement used in soliciting acceptances of a plan of reorganization. Such plans often provide for the exchange of new securities for claims and interests of creditors and shareholders of the debtor. The Bankruptcy Code provides that adequate disclosure is to be made without regard to whether or not the information provided would otherwise comply with the disclosure requirements of the federal securities laws. However, in recognition of the Commission's special expertise on disclosure questions, the Bankruptcy Code recognizes the

Commission's right to be heard, distinct from its special advisory role, on the adequacy of disclosure. For this reason, the Bankruptcy Rules require service on the Commission of all disclosure statements.

During fiscal year 1990, the Commission received over 6,000 disclosure statements filed in Chapter 11 cases involving both privately-held and publicly-held corporations. The staff limits its review to those disclosure statements filed in cases involving a publicly-held company or a company likely to be publicly traded as a consequence of the reorganization. During 1990, the staff reviewed 93 disclosure statements.

In its review of disclosure statements, the staff seeks to determine whether the issuance of securities under a plan is consistent with the exemption from registration in the Bankruptcy Code and otherwise in compliance with the federal securities laws. The Commission also reviews statements to determine whether there is adequate disclosure concerning the proposed plan. Generally, the Commission seeks to resolve questions concerning bankruptcy disclosure through staff comments to the plan proponent. If questions cannot be resolved through this process, the Commission may object to the disclosure statement in the bankruptcy court. During fiscal year 1990, the Commission commented on disclosure statements in 57 cases. The vast majority of the Commission's comments were adopted by debtors. The Commission was compelled to object to disclosure statements in three cases.[306] In *In re American Medical Technology, Inc.*[307] and *In re Saratoga Standardbreds, Inc.*,[309] the Commission filed objections to proposed plans of substantially assetless publicly-held shell corporations. Both plans contemplated no business operations but sought, contrary to Section 1141(d)(3) of the Bankruptcy Code, to employ the discharge provisions of Chapter 11 to discharge claims of creditors.

In both cases the principal purpose of the plan was to emerge from Chapter 11 as a publicly-traded company -without assets or liabilities and to merge with operating businesses at some unspecified time in the future. In addition, the Commission viewed the use of Chapter 11 by corporate shells to cleanse themselves of liabilities as an abuse of the reorganization process. In American Medical, the bankruptcy court agreed with the Commission's position and sustained its objection. In Saratoga, the bankruptcy court overruled the Commission's objection in light of the debtor's showing that after reorganization it would have had sufficient funds to meet its reporting obligations under the Exchange Act.

The Commission also objected in SIS Corp. to confirmation of the debtor's plan of liquidation because it sought to discharge all claims of creditors. The debtor's plan appeared to be structured in a manner that would enable the debtor to resurrect its corporate shell after confirmation. In denying confirmation, the court agreed with the Commission's position.

In *In re Southmark Corp.*[309] and *In re SIS Corp.*,[310] the Commission filed objections to the confirmation of proposed plans, arguing, as it has on several other occasions,[311] that the provisions of the plan that purported to discharge and release non-debtor liability should be stricken or revised because such provisions are beyond the confines of the Bankruptcy Code discharge of liability.

In *Southmark*, the provision also would have protected non-debtor third parties from future Commission enforcement actions. Citing Underhill v. Royal, 769 F.2d 1426 (9th Cir. 1985), the Commission argued that Section 524(e) of the Code does not empower a bankruptcy court to discharge the liabilities of non-debtors pursuant to a plan of reorganization -- that is, a bankruptcy court can affect only the relationships of debtors and creditors and cannot discharge the

liabilities of a non-debtor. In *Southmark*, in response to the Commission's objection, the debtor amended its plan both to exclude Commission enforcement proceedings from the operation of the discharge and release provision and also to exclude most public investors. However, the bankruptcy court approved the plan containing the release provision on the theory that it was consensual, since creditors were given an opportunity to, in effect, “opt out” of the scope of the release provision. In *SIS Corp.,* following the court's oral statement that the release provision was “unacceptable,” the debtor deleted the provision from its plan.

Compliance with the Registration Requirements of the Securities Act

Section 1145 of the Bankruptcy Code contains a limited exemption from registration under the Securities Act for the distribution of securities by a debtor, or an affiliate or successor to the debtor, pursuant to a plan of reorganization and in exchange for claims against or securities of the debtor or such affiliate.

The issuance of securities pursuant to a plan is deemed to be a “public offering,” which means that there is no restriction on resale of such securities unless the seller is an “underwriter” as specifically defined in Section 1145(b). During the fiscal year, the staff had no occasion to file formal objections to a reorganization plan on the basis of violations of Section 1145 of the Bankruptcy Code.

ECONOMIC RESEARCH AND ANALYSIS

The Office of Economic Analysis (OEA) provides technical support and analysis to assist in evaluating the economic aspects of the Commission's regulatory program. The economics staff provides the Commission with research and advice on rule proposals, policy initiatives, and enforcement actions. The staff assists the Commission in making decisions affecting the efficiency and structure of our nation's securities industry. In addition, the staff monitors developments in capital markets around the world and major program initiatives affecting the United States financial services industry, markets, and investors.

Key 1990 Results

Application of new technology within the securities industry, increased complexity of new financial products, and development of new trading strategies have resulted in a more dynamic domestic securities market. The United States securities industry has been a leader in financial innovation for many years. United States securities markets continue to benefit from a regulatory structure that fosters both competition and the protection of investors and, thereby, promotes both public confidence and operational efficiency in the markets.

A comprehensive program of economic and policy analysis is provided by the economics staff, focusing on issues related to corporate restructuring, stock price volatility, mutual fund performance, disclosure, insider trading, and market manipulation.

The market decline of October 1989 renewed the debate over the effectiveness and economic consequences of circuit breaker mechanisms. The wave of going-private transactions and junk bond financings that took place during the 1980's continues to require the attention of the office. Concern in this area was heightened by the failure of Drexel Burnham Lambert, the decline in the junk bond market, and some highly publicized cases of financial difficulty following going-private transactions.

Continued discussion of proposals for comprehensive reform of financial services regulation, including the possible repeal of the Glass-Steagall Act, requires analysis of the economic implications of merging banking, insurance, and broker-dealer activities. The need for this analysis is made all the more critical by the deepening concerns over our national system of deposit insurance. Along these lines, OEA reported that an analysis of bank bond yield spreads and some direct estimates of deposit insurance premiums (using the option pricing model) strongly suggest that deposit insurance is currently underpriced and that the current practice of flat-pricing for insurance does not recognize the wide variation of risk across banks. In the investment company area, the proliferation of funds and fund types, coupled with marketing techniques by investment companies, including the use of 12b-1 fees, has resulted in complex disclosure issues that can benefit from economic analysis.

The staff reviewed rule proposals encompassing the full range of the Commission's regulatory program. The staff also provided advice, technical assistance, and empirical analyses of issues of concern to the Commission and its operating divisions. The controversy surrounding the growth of the penny stock market also has required increased attention by the economics office. Also, monitoring programs were developed and maintained to study the impact of major rules, new trading facilities, and market developments.

Key accomplishments include completion of studies on issues such as:

- the performance of circuit breaker mechanisms during the October 1989 market decline;

- the market's reaction to pension terminations and the relationship of such termination to corporate takeovers; and

- the effects of share turnover and margin credit on stock market volatility.

Substantial progress was made toward completion of ongoing studies of the following issues:

- post-offering price performance of blank check offerings and incidence of securities laws violations;

- going-private transactions;

- the effects of institutional ownership on equity market liquidity and the willingness of corporate management to invest in long-term projects;

- the relationship between insider trading and share price movements preceding significant corporate announcements;

- the rule that permits mutual funds to use fund assets to pay for distributions;

- the effects of cross-border listing and stock price volatility; and

- deposit insurance pricing.

In addition, the staff provided technical advice and assistance to the Commission's operating divisions on a wide variety of issues. OEA, for example, furnished the Commission and divisions with a quarterly report on the financial health of the securities industry. In the enforcement area, OEA worked on diversified cases, including insider trading, disclosure violations, suitability, and market manipulation. The staff also assisted the penny stock task force in monitoring the impact of the task force efforts on the number of penny stock dealers. In the securities market area, OEA examined the impact of Rule 10b-21 (T) pertaining to short-selling restrictions in connection with a public offering of securities, and monitored Rule 19c-3, which allows exchange members to make off-board markets in newly listed stocks.

In the international area, the staff continued to monitor the extent and nature of international trading in securities, foreign and United States portfolio investment patterns, the growth of the international bond and equity markets, and restructuring in overseas markets.

MANAGEMENT AND PROGRAM SUPPORT

Management and Program Support provides the Commission and operating divisions with management and administrative services in support of the Commission's objectives. Management support includes overseeing the allocation and expenditure of agency funds, liaison with Congress, disseminating information to the press, facilitating Commission meetings, and developing and executing management policies. Administrative support includes services such as accounting, data processing, staffing, and space management.

Key 1990 Results

Fiscal year 1990 was highlighted by a number of significant activities. In particular, the Commission held 59 meetings and considered 277 matters. Two significant pieces of legislation—the Market Reform Act of 1990 and the Securities Enforcement Remedies and Penny Stock Reform Act—were enacted to increase the Commission's ability to protect investors and strengthen the financial integrity of the securities markets. A third law enacted, the International Securities Enforcement Cooperation Act, will facilitate the flow of enforcement information domestically and internationally, and enable the Commission to sanction United States violators of foreign securities laws.

Among other significant accomplishments were the collection of fee revenue of $232 million, compared to an appropriation level of $167 million, and enactment of the Commission's authorization bill, the Securities Act Amendments of 1990, which gives the Commission

authority to enter into leases directly, exempt from General Services Administration space management regulations or directives. In addition, the Commission staff responded to 51,914 complaints and inquiries from investors.

Office of the Secretary

The Commission held 59 meetings in fiscal year 1990, during which it considered 277 matters including rule proposals, enforcement actions, and other items that affect significantly the stability of the markets and the nation's economy. Significant actions of the Commission included:

- adopting Rule 144A to establish a non-exclusive safe harbor from registration requirements for resales of restricted securities under the Securities Act of 1933 to a specified class of institutional investors;

- adopting Regulation S to clarify the extraterritorial application of the registration requirements of the Securities Act of 1933;

- issuing a release to solicit comments on reform of investment company regulation under the Investment Company Act of 1940 and the Investment Advisers Act of 1940 and related statutes;

- proposing amendments to Rule 2a-7 under the Investment Company Act of 1940 to tighten requirements for portfolio quality, maturity, and diversity of money market funds; and

- issuing a concept release to solicit public comment on permitting foreign tender offers to proceed in the United States based upon foreign law documentation and procedures.

Office of Legislative Affairs

At the end of the fiscal year, Congress passed two significant pieces of legislation that substantially increase the Commission's ability to regulate the securities markets and give the Commission new enforcement powers. The Market Reform Act of 1990 (Public Law 101-432) authorizes the Commission to adopt rules and procedures to enhance financial oversight, efficient clearance and settlement, and market stability and to deter fraud and manipulation in the securities markets. The Securities Enforcement Remedies and Penny Stock Reform Act (Public Law 101-429) expands the Commission's powers by, among other things, authorizing it to seek court orders imposing civil monetary penalties for any securities law violation and to impose such penalties in administrative proceedings against broker-dealers and other regulated entities. A third major piece of legislation—the International Securities Enforcement Cooperation Act—which was passed as part of the Commission's authorization bill—will facilitate greater access to enforcement information and permits the Commission to sanction United States violators of foreign securities laws.

Congressional interest in the Commission's activities and initiatives continued at a high level. As a result, the Office of Legislative Affairs increased its efforts to track proposals and accommodate congressional requests for documents and information. The office coordinated and drafted testimony for 19 congressional hearings, including three confirmation hearings, during the course of the year.

Office of Public Affairs

The Office of Public Affairs communicates information on Commission activities to those interested in or affected by

Commission actions, including the press, the general public, regulated entities, and employees of the Commission through ongoing programs and special projects. The office publishes the SEC *News Digest* daily, which provides information on rule changes, enforcement actions against individuals or corporate entities, acquisition reports, releases, decisions on requests for exemptions, upcoming Commission meetings, and other events of interest. The office publishes a regular newsletter and prepares a daily summary of news clips for Commission employees. Special projects, such as support for activities related to the recently formed Emerging Markets Advisory Committee for Eastern Europe, were undertaken in support of the Commission's mission. Information on Commission activity also is disseminated through notices of administrative actions, litigation releases, and other materials.

Another important function is the coordination of the Commission's interaction with the press. Many Commission actions are of nationwide and, increasingly, international interest. When appropriate, these actions are drawn to the attention of regional, national, and international press. The office also issues press releases on upcoming events, Commission programs, and special projects. A total of 69 news releases were issued during the year.

In addition, the office responded to approximately 87,000 requests for specific information on the Commission or its activities. The office also coordinates the visits of national and foreign officials to the Commission. In total, programs for 327 foreign visitors were coordinated in fiscal year 1990.

Office of the Executive Director

The Commission's management staff initiated or continued special projects, such as coordinating the agency's effort to join the NASD's

Central Registration Depository system, and the agency's internal control and audit follow-up responsibilities pursuant to the Inspector General Act Amendments of 1988. The management staff worked closely with the Chairman and other senior officials in formulating the agency's budget submissions for the Office of Management and Budget and Congress.

Equal Employment Opportunity. The Executive Director's Office also implemented improvements to the Commission's Equal Employment Opportunity (EEO) programs. These improvements included:

- hiring two EEO specialists with specialized experience in developing and implementing affirmative employment programs and processing discrimination complaints;

- selecting a Commission employee for the collateral duty position of Federal Women's Program (FWP) manager;

- increasing membership by 100 percent on the Federal Women's Program Committee;

- publishing policy statements by Chairman Breeden on equal employment opportunity and affirmative employment, prevention of sexual harassment, and the promotion of minority professionals;

- completing the Affirmative Employment Plan for minorities and women;

- conducting off-site EEO training for 120 agency managers and supervisors, EEO counselors, and members of the Federal Women's Program;

- developing EEO reference books for use by EEO collateral duty personnel and a new pamphlet on the prevention of sexual harassment;

- improving the statistical reporting system for EEO reports to the Equal Employment Opportunity Commission and the Office of Personnel Management;

- reducing substantially the number of informal and formal discrimination complaints through use of creative conflict resolution approaches to problems; and

- creating the Jeanne Gerber Hartford Award in the name of the former FWP manager to be presented annually at the Women's History Month Observance at the Commission.

The Commission continued to actively recruit minorities and women. At the end of the fiscal year, women accounted for 48.6 percent of the total Commission work force; blacks accounted for 27.5 percent; Hispanics accounted for approximately 3 percent; Asian-Americans made up 1.4 percent; and American-Alaskan natives made up .04 percent.

Administrative Support

The administrative support offices provide the financial, data processing, personnel, and facilities support necessary for the Commission to carry out its mission. Under the direction of the Office of the Executive Director, these support services are provided by the Offices of the Comptroller, Information Systems Management, Personnel, Administrative Services, Consumer Affairs and Information Services, and Applications and Reports Services.

Commission Operations. In fiscal year 1990, for the eighth consecutive year, the Commission collected revenue for the United States Treasury in excess of its appropriation. The Commission collected fee revenue of $232 million compared to a final appropriations level of $167 million — a $65 million net gain to the United States Treasury. Fee revenue is collected from four basic sources: registrations under the Securities Act of 1933 (comprising 61 percent of total fiscal year 1990 fee revenue); transactions on securities exchanges (30 percent); tender offer and merger filings (6 percent); and miscellaneous filings (3 percent).

Financial Management. The agency completed its second year of operating the new accounting system, the Federal Financial System (FFS). The FFS provided the agency with significant automation improvements such as:

- entering voucher and payment data directly into the system;
- creating travel authorization and procurement documents;
- providing decentralized data throughout the Commission;
- accomplishing voucher research on-line; and
- making management data more readily available.

The Commission continued to improve its automated collection and processing of annual fee revenue through electronic funds transfer (EFT), and a Treasury sponsored “lockbox” depository system. The Commission received over 43,000 separate fee payments of differing amounts for transactions of exchange listed securities and required and elective reports from about 15,000 companies. The Commission

staff began reviewing the possibility of collecting fee payments by credit card, and the redesign of an automated fee tracking, reporting, and accounts receivable system was begun.

Information Systems Management. During fiscal year 1990, the Office of Information Systems Management continued to modernize the Commission's automated data processing and information management services. These efforts included:

- enhancing the Division of Enforcement's capacity to monitor market activity by creating an automated tool that will “report out of range” events;

- completing a pilot test of the NASD's Central Registration Depository system, which will allow the Commission to automatically receive broker-dealer registration information;

- completing a functional requirements analysis for the new Electronic Filing Fee Collection system, which will consolidate information for Commission filings and associated fees; and

- implementing a Wide Area Network (WAN) by connecting both the Denver and Boston regional offices' local area networks through a dedicated communication line to headquarters.

Throughout the year, improvements to office automation technologies and networking capabilities helped improve staff productivity.

Personnel Management. The Office of Personnel revised regulations on performance appraisals, the performance management and recognition system, leave transfers, emergency dismissals, and position classification appeals in accordance with government-wide

changes. In addition, the Commission's drug-free workplace plan was approved, and steps were begun toward full implementation of that plan.

The number of internal and outside courses attended by Commission employees increased by 68 percent from 2,200 courses attended in fiscal year 1989 to 3,700 in fiscal year 1990. In response to continued Commission emphasis on information systems automation, 1,145 employees were trained on computer systems and applications. In addition, the office provided requested training to 700 staff members to enhance or improve their on-the-job performance.

The Office of Personnel extended to all areas of the country its localized employee assistance program contract services for staff and their families needing special help, primarily for counseling and referral services. The employee assistance counselors also support the Commission's drug-free workplace plan by providing education, consultation, and referral services.

Due to a significant increase in the agency's staffing level in 1990, the Commission conducted its largest recruitment campaign in the last five years. Despite noncompetitive salaries and high turnover, over 500 new employees were hired, resulting in a net increase of over 250 employees. Emphasis was placed on the recruitment of attorneys, accountants, securities compliance examiners, computer specialists, and secretaries. The significant hiring was accomplished through aggressive use of delegated examining authority, special OPM hiring programs, and advertising and attendance at numerous OPM job fairs.

In cooperation with the Office of Equal Employment Opportunity, the Office of Personnel co-sponsored several activities, including a three-day conference to train EEO program workers, supervisors, and

executives from regional and headquarters offices. In addition, the system to monitor and record employee compliance with the Commission's rules of conduct was revised and expanded. To recognize employee performance, the Commission awarded more than $1 million in incentive and performance awards.

Facilities Management. The Commission requested and obtained independent leasing authority from Congress in its authorization bill that was enacted into law on November 15, 1990. Provisions in the bill remove the Commission from restrictions of General Services Administration (GSA) office leasing requirements. Over time this will give the Commission the flexibility to provide more appropriate working conditions for the staff. The new authority also will save both time and money in the acquisition of space.

Earlier in the fiscal year, the Commission obtained temporary Delegated Procurement Authority from the GSA for the acquisition of 21,000 square feet of expansion space within the headquarters building. The Commission staff began relocating the Denver, Chicago, Atlanta, and Miami field offices and will continue this effort in fiscal year 1991.

The Office of Administrative Services awarded contracts and purchase orders in excess of $30 million during fiscal year 1990, an increase of approximately $12 million over the previous fiscal year. The total number of actions was 2,495, a 26 percent increase over 1989. A significant portion of the increase is attributed to computer equipment, software, and service-related procurements. In other areas, the office increased its printing production from 50.8 million units to 60.4 million; incoming mail increased by approximately five percent over the preceding fiscal year, while outgoing mail increased by approximately eight percent. The installation of a new telephone answering system in the publications section improved the

Commission's response time to public requests for documents and forms.

Consumer Affairs and Information Services. The Office of Consumer Affairs and Information Services is responsible for (1) responding to investor complaints and inquiries; (2) screening information received to make referrals to SEC program divisions, self-regulatory agencies, states, or other federal agencies; (3) collecting and analyzing complaint information and trends to help target regulatory and enforcement activities; and (4) preparing educational materials to assist investors in protecting their interests. In addition, the office processes requests for information under statutes such as the Freedom of Information Act (FOIA) and the Privacy Act (PA).

The Commission's consumer affairs staff responded to a total of 51,914 complaints and inquiries from investors, an increase of 15 percent over those received in fiscal year 1989. A total of 40,109 were complaints and 11,805 were inquiries. Of the total received, complaints about program trading totaled 14,921 (37 percent) while 14,260 complaints involved broker-dealers (36 percent). Broker-dealer complaints declined almost 17 percent from those received last fiscal year. High pressure or fraudulent sales practices were identified as the most prevalent type of complaint against broker-dealers. Complaints against penny stock broker-dealers declined from 3,863 in fiscal year 1989 to 2,023 in fiscal year 1990, accounting for approximately 14 percent of all broker-dealer complaints this fiscal year. The remainder of complaints were divided primarily among issuers, mutual funds, banks, transfer agents, and investment advisers.

In order to improve responsiveness to the public and support to the program divisions, the office made substantial progress in the re-design and development of a new Commission computerized

complaint tracking system. This is a multi-year effort begun in fiscal year 1989, and is scheduled to be implemented in mid-1991. The new system will permit more thorough analysis of complaint information and trends and increase the timeliness of Commission responses to investors and other members of the public. Another mission of the Office of Consumer Affairs and Information Services involves responding to a variety of information requests pursuant to federal access laws, and processing requests for confidential treatment. The office processed 2,232 FOIA requests and appeals, 30 PA requests and appeals, 57 Government in the Sunshine Act requests, 22 government referrals, and 3,352 requests and appeals for confidential treatment. Confidential treatment requests are typically made in connection with proprietary corporate information and are carefully evaluated in connection with access requests to prevent the unwarranted disclosure of information exempt under the FOIA. A total of 96 percent of all FOIA/PA requests were responded to within the statutory time frame. The remaining four percent of the requests involved voluminous records and were placed in a first-in/ first-out system for the actual review and production of records. In addition, the FOIA/PA staff coordinated 1,014 requests for Commission records from members of Congress.

Public Reference. In a continuing interest to serve the public, the procedures in the headquarters public reference room were enhanced to ensure expeditious identification, location, and retrieval of documents and microfiche. The staff answered questions and completed requests for documents from over 57,000 visitors to the headquarters public reference room. Nearly 288,000 paper documents and 335,353 microfiche records were added to the existing library of publicly available information, which were maintained amid constant use by these visitors. In addition, the staff processed over 500 formal requests for certifications of Commission filings and responded to more than 40,000 requests for microfiche

records, about 5,100 requests for paper filings, and over 123,000 telephone inquiries regarding filings.

COMMISSION MEMBERS AND PRINCIPAL STAFF OFFICERS

Term Expires 1993 1992 1994 1991 1995

Richard C. Breeden, *Chairman* (Term Expires 1993)
Edward H. Fleischman (Term Expires 1992)
Mary L. Schapiro (Term Expires 1994)
Philip R. Lochner, Jr. (Term Expires 1991)
Richard Y. Roberts (Term Expires 1995)
Executive Assistant to the Chairman: **Marianne K. Smythe**

Principal Staff Officers

James M. McConnell, *Executive Director*
Kenneth A. Fogash, *Deputy Executive Director*

Linda C. Quinn, *Director, Division of Corporation Finance*
Elisse B. Walter, *Deputy Director*
Mary E. T. Beach, *Associate Director*
Ernestine M. R. Zipoy, *Associate Director*
Robert Bayless, *Associate Director*
Mauri L. Osheroff, *Associate Director*
William E. Morley, *Associate Director*

William R. McLucas, *Director, Division of Enforcement*
Bruce A. Hiler, *Associate Director*
Harry J. Weiss, *Associate Director*
Joseph I. Goldstein, *Associate Director*

Colleen P. Mahoney, *Chief Counsel*
Thomas C. Newkirk, *Chief Litigation Counsel*

Richard G. Ketchum, *Director, Division of Market Regulation*
Mark D. Fitterman, *Associate Director*
Brandon C. Becker, *Associate Director*
Larry E. Bergmann, *Associate Director*

VACANT, *Director, Division of Investment Management*
VACANT, *Associate Director*
Gene A. Gohlke, *Associate Director*
Mary S. Podesta, *Associate Director*
William C. Weeden, *Assistant Director, Office of Public Utility Regulation*

James R. Doty, *General Counsel*
Paul Gonson, *Solicitor*
Jacob H. Stillman, *Associate General Counsel*
VACANT, *Associate General Counsel*
Phillip D. Parker, *Associate General Counsel*
William S. Stern, *Associate General Counsel*

Michael D. Mann, *Director, Office of International Affairs*

Edmund Coulson, *Chief Accountant*
Glen L. Davison, *Deputy Chief Accountant*

Kenneth Lehn, *Chief Economist, Office of Economic Analysis*
Jeffry L. Davis, *Deputy Chief Economist*
Terry M. Chuppe, *Associate Chief Economist*
David H. Malmquist, *Associate Chief Economist*

Jonathan G. Katz, *Secretary*

Margaret H. McFarland, *Deputy Secretary*

Mary M. McCue, *Director, Office of Public Affairs*
John D. Heine, *Senior Public Affairs Specialist*

Gary E. Fendler, *Director of Communications*
Warren E. Blair, *Chief Administrative Law Judge*

Lawrence H. Haynes, *Comptroller*
Henry I. Hoffman, *Assistant Comptroller*

Richard J. Kanyan, *Director, Office of Administrative Services*
David L. Coman, *Deputy Director*

VACANT, *Director, Office of Personnel*
William E. Ford, II, *Assistant Director*

Wilson A. Butler, Jr., *Director, Office of Applications and Reports Services*
Marie B. Simpson, *Deputy Director*

Bonnie Westbrook, *Director, Office of Consumer Affairs and Information Services*

Gregory Jones, Sr., *Director, Office of Information Systems Management*
VACANT, *Deputy Director*

R. Mitchell Delk, *Director, Office of Legislative Affairs*

James A. Clarkson, III, *Director of Regional Office Operations*

VACANT, *Manager, Equal Employment Opportunity*

John O. Penhollow, *Director, Office of EDGAR Management*

BIOGRAPHIES OF COMMISSION MEMBERS

Chairman — Richard C. Breeden

Following his nomination by President Bush and confirmation by the United States Senate, Richard C. Breeden was sworn in as the 24th Chairman of the Commission on October 11, 1989. As one of the youngest Chairmen in the agency's history, Mr. Breeden is responsible for leading the Commission in the development of policy and for overall direction of the Commission. Mr. Breeden also represents the Commission to the Congress, the Administration, the financial community, and the public at large. Mr. Breeden serves as a member of the President's Working Group on Financial Markets. He was also appointed by President Bush to serve on the Council of the Administrative Conference of the United States.

In the fall of 1990, Mr. Breeden was elected by his colleagues from the largest securities markets in the world to serve as Chairman of the Technical Committee of the International Organization of Securities Commissions (IOSCO) for a two-year term. In this capacity, Mr. Breeden is responsible for leading the efforts of securities regulatory agencies worldwide in seeking to develop international regulatory standards for securities markets. Mr. Breeden also served as Chairman of the Executive Committee of IOSCO from 1989-1990.

From the Inauguration of President Bush until he assumed the Chairmanship, Mr. Breeden served in the White House as Assistant to the President for Issues Analysis. In this capacity, Mr. Breeden

was responsible for coordinating the development of Executive Branch policies concerning specific problems such as the savings and loan industry crisis.

From 1982-1985, Mr. Breeden served as Deputy Counsel to then-Vice President Bush, working on a wide range of regulatory problems. In addition, he served as Staff Director of the Vice President's Task Group on Regulation of Financial Services, a cabinet level group established to recommend improvements in federal financial regulatory programs. *Blueprint for Reform,* the Task Group's final report, authored by Mr. Breeden, was issued in November 1984. From 1981-1982, Mr. Breeden served as Executive Assistant to the Undersecretary of Labor.

Mr. Breeden is a lawyer by training. From 1985-1989, he was a partner in the Washington office of a major law firm, where his legal practice included financial transactions and regulatory matters of all types. Prior to his original government service, Mr. Breeden practiced law in New York City from 1976-1981, where he handled securities underwriting, bank financing, and major domestic and international business transactions. This followed completion of an appointment to teach constitutional law and federal jurisdiction at the University of Miami School of Law. Mr. Breeden was educated at Stanford University (B.A. with honors in international relations, 1972) and Harvard Law School (J.D., 1975).

Commissioner — Edward H. Fleischman

Edward H. Fleischman was sworn in as the 66th Member of the Securities and Exchange Commission on January 6, 1986. His term expires in June 1992.

Mr. Fleischman was admitted to the New York Bar in 1959 and to the bar of the U.S. Supreme Court in 1980. He formerly practiced law with Beekman & Bogue (a predecessor of the present Gaston & Snow firm), where he specialized in securities and corporate law and related areas.

During his career, Mr. Fleischman has been elected a member of the American Law Institute, the American College of Investment Counsel (of which he is currently President) and the American Society of Corporate Secretaries, and has served as an Adjunct Professor of Law teaching securities regulation at the New York University Law School.

Mr. Fleischman was born in Cambridge, Massachusetts on June 25, 1932. He received his undergraduate education at Harvard College, served in the U.S. Army from 1952 to 1955, and obtained his LL.B degree from Columbia Law School.

Mr. Fleischman serves on the American Bar Association Section of Business Law's Committee on Counsel Responsibility and chairs the Committee on Developments in Business Financing. He co-drafted that Committee's 1979 paper on resale of institutional privately-placed debt and chaired its Subcommittees on Simplified Indenture and on Annual Review of Developments. He also serves on the Committee on Federal Regulation of Securities, for which he chaired Subcommittees on Rule 144 and on Broker-Dealer Matters and co-drafted the Committee's 1973 letter on utilization and dissemination of “inside” information. In addition, he serves on the Committee on Futures Regulation and the Committee on Developments in Investment Services, and has been active in the Section on Administrative Law.

Mr. Fleischman is also a member of Committee E—Banking Law and of Committee Q—Issues and Trading in Securities of the International Bar Association Section on Business Law. In the International Law Association (American Branch), he has been appointed to membership on the Committee on International Regulation of Securities.

Commissioner — Mary L. Schapiro

Mary L. Schapiro was sworn in as the 67th Member of the Securities and Exchange Commission on December 5, 1988. She was nominated to the Commission by President Reagan on December 22, 1988 in a recess appointment. Ms. Schapiro was renominated to the Commission by President Bush on November 8, 1989 and confirmed by the Senate on November 18, 1989. Her term expires on June 5, 1994.

Ms. Schapiro came to the Commission from the Futures Industry Association, where she was General Counsel and Senior Vice President. While at the FIA, her work included regulatory, tax and international issues, including extensive liaison with foreign governmental officials.

Prior to her service at the FIA, Ms. Schapiro spent four years at the Commodity Futures Trading Commission. There, she served as Counsel and Executive Assistant to the Chairman of the Commodity Futures Trading Commission and was a Trial Attorney in the Manipulation and Trade Practice Investigations Unit of the Division of Enforcement. In the former position, Ms. Schapiro advised on all regulatory and adjudicatory matters pending before the Commission and on legislation. She also represented the Chairman with federal and state officials, Congress, and the futures industry, in addition to other duties.

A 1977 honors graduate of Franklin and Marshall College in Lancaster, Pennsylvania, Ms. Schapiro earned a Juris Doctor degree (with honors) from The National Law Center of George Washington University in 1980. While in law school, Ms. Schapiro completed internships in the Farm Credit Administration and in the Executive Office of the President. She is a member of the District of Columbia Bar, the American Bar Association, and the Association of the Bar of the City of New York. From 1986 to 1988, she served on the Executive Council of the Committee on Futures Regulation of the American Bar Association.

Commissioner — Philip R. Lochner, Jr.

Philip R. Lochner, Jr. was sworn in as the 68th Member of the Securities and Exchange Commission on March 12, 1990 by the Honorable Stanley Sporkin, Judge of the United States District Court for the District of Columbia. Mr. Lochner was nominated to the Commission by President Bush in January 1990 for a term expiring in 1991.

Before being nominated to the Commission, Mr. Lochner was General Counsel, Secretary, and Vice President for Time Warner Inc. He became General Counsel and Secretary in September 1988. He was elected a Vice President of Time Warner Inc. in October 1986, and also assumed responsibility for Corporate Human Resources that year. From 1984 to 1986, he served as Senior Vice President and General Counsel for the Time Warner Inc. Video Group. Prior to that, he was Corporate Associate General Counsel for Time Warner Inc. for four years, having joined the company in 1978 as Associate General Counsel.

Before joining Time Warner Inc., Mr. Lochner was with the law firm of Cravath, Swaine & Moore. He joined the law firm in 1973 after serving, from 1971 to 1973, as an Associate Dean and Assistant Professor of Law at State University of New York in Amherst, New York.

Mr. Lochner earned a Ph.D. in political science from Stanford University in 1971. He also studied at the University of London from 1967 to 1968 as a Fulbright Fellow. Mr. Lochner earned a LL.B. degree from Yale University in 1967, where he was on the Board of Editors of the Yale Law Journal, and was a member of the Order of the Coif. He earned a B.A. from Yale University in 1964 and was elected to Phi Beta Kappa.

His professional activities include the New York State Bar Association, where he served as Chairman of the Corporate Counsel Section, and has also served as a member of the Committee on Corporation Law for the Banking, Corporation, and Business Law Section of that Association. Mr. Lochner is a Fellow of the American Bar Foundation and he served as a lecturer on securities law matters for the Practising Law Institute. He is a member of the American, New York State, and City of New York Bar Associations, and the American Law Institute.

Mr. Lochner was born in New Rochelle, New York on March 3, 1943. He and his wife, Sally, have two children.

Commissioner — Richard Roberts

Richard Roberts was nominated to the Commission by President Bush and confirmed by the Senate on September 27, 1990. He was sworn in as a Commissioner on October 1, 1990 by the Honorable

Stanley Sporkin, Judge for the United States District Court of the District of Columbia. His term expires in June 1995.

Before being nominated to the Commission, Mr. Roberts was in the private practice of law with the Washington office of Miller, Hamilton, Snider & Odom. Before joining the law firm in April 1990, Mr. Roberts was administrative assistant and legislative director for Senator Richard Shelby (D., Ala.), a position he assumed in 1987. Prior to that, Mr. Roberts was, for four years, in the private practice of law in Alabama. From 1979 to 1982, Mr. Roberts was administrative assistant and legislative director for then-Congressman Shelby.

Mr. Roberts is a 1973 graduate of Auburn University and a 1976 graduate of the University of Alabama School of Law. He also received a Master of Laws in taxation from the George Washington University National Law Center in 1981. He is admitted to the bar in the District of Columbia and Alabama. Mr. Roberts is a member of the National Association of Bond Lawyers, the American Bar Association, the Alabama State Bar Association, and the District of Columbia Bar Association.

He and his wife, the former Peggy Frew, make their home in Fairfax, Virginia with their son and two daughters.

Mr. Roberts was born in Birmingham, Alabama on July 3,1951.

REGIONAL AND BRANCH OFFICES AND ADMINISTRATORS

REGION 1

Lawrence lason
NEW YORK REGIONAL OFFICE
75 Park Place, 14th Floor
New York, NY 10007
212/264-1636
Region: New York and New Jersey

REGION 2

Douglas Scarff
BOSTON REGIONAL OFFICE
John W. McCormack Post Office and Courthouse Building,
Suite 700 Boston, MA 02109
617/223-9900
Region: Maine, New Hampshire, Vermont, Massachusetts,
Rhode Island, and Connecticut

REGION 3

Richard P. Wessel
ATLANTA REGIONAL OFFICE
1375 Peachtree Street, NE, Suite 788
Atlanta, GA 30367
404/347-4768

Region: Tennessee, Virgin Islands, Puerto Rico, North Carolina, South Carolina, Georgia, Alabama, Mississippi, Florida, and Louisiana east of the Atchafalaya River

Charles C. Harper
MIAMI BRANCH OFFICE
Dupont Plaza Center
300 Biscayne Boulevard Way, Suite 500
Miami, FL 33131
305/536-5765

REGION 4

William D. Goldsberry
CHICAGO REGIONAL OFFICE
Everett McKinley Dirksen Building
219 South Dearborn Street, Room 1204
Chicago, IL 60604
312/353-7390
Region: Michigan, Ohio, Kentucky, Wisconsin, Indiana, Iowa, Illinois, Minnesota, and Missouri

REGION 5

T. Christopher Browne
FORT WORTH REGIONAL OFFICE
411 West Seventh Street, 8th Floor
Fort Worth, TX 76102
817/334-3821
Region: Oklahoma, Arkansas, Texas, Louisiana west of the Atchafalaya River, and Kansas

Joseph C. Matta

HOUSTON BRANCH OFFICE
7500 San Felipe Street, Suite 550
Houston, TX 77063
713/266-3671

REGION 6

Robert H. Davenport
DENVER REGIONAL OFFICE
410 17th Street, Suite 700
Denver, CO 80202
303/844-2071
Region: North Dakota, South Dakota, Wyoming, Nebraska, Colorado, New Mexico, and Utah

Donald M. Hoerl
SALT LAKE BRANCH OFFICE
U.S. Post Office and Courthouse
350 South Main Street, Room 505
Salt Lake City, UT 84101
801/524-5796

REGION 7

James L. Sanders

LOS ANGELES REGIONAL OFFICE
5757 Wilshire Boulevard, Suite 500
East Los Angeles, CA 90036-3648
213/965-3998
Region: Nevada, Arizona, California, Hawaii, and Guam

Cer Gladwyn Goins

SAN FRANCISCO BRANCH OFFICE
901 Market Street, Suite 470
San Francisco, CA 94103
415/744-3110

REGION 8

Jack H. Bookey
SEATTLE REGIONAL OFFICE
3040 Jackson Federal Building
915 Second Avenue
Seattle, WA 98174
206/442-7990
Region: Montana, Idaho, Washington, Oregon, and Alaska

REGION 9

James C. Kennedy
PHILADELPHIA REGIONAL OFFICE
The Curtis Center, Suite 1005 E. 601 Walnut Street
Philadelphia, PA 19106-3322
215/597-3100
Region: Pennsylvania, Delaware, Maryland, Virginia, West Virginia, and District of Columbia

ENDNOTES

[1]*SEC v. Finacor Anstalt,* Litigation Release No. 12296 (November 20, 1989), 44 SEC Docket 2231.

[2]*SEC v. Certain Purchasers of Common Stock and Call Option Contracts for the Common Stock of Contel Corporation,* Litigation Release No. 12542 (July 13, 1990), 46 SEC Docket 1395.

[3]*SEC v. Fondation Hai,* Litigation Release No. 12353 (January 18, 1990), 45 SEC Docket 714.

[4]*SEC v. Jason M. Chapnick,* Litigation Release No. 12657 (October 4, 1990), 47 SEC Docket 784.

[5]*SEC v. Security National Bancorp, Inc. and Wesley Godfrey, Jr.,* Accounting and Auditing Enforcement Release No. 253 (February 6, 1990), 45 SEC Docket 1046.

[6]*SEC v. John E. Parigian,* Accounting and Auditing Enforcement Release No. 257 (May 18, 1990), 46 SEC Docket 515.

[7]*SEC v. Jiro Yamazaki and lkuko Sekiguchi-Yamazaki,* Litigation Release No. 12507 (June 11, 1990), 46 SEC Docket 865.

[8]*SEC v. Power Securities Corporation,* Litigation Release No. 12605 (September 6, 1990), 46 SEC Docket 2073.

[9]*SEC v. Blinder, Robinson & Co., Inc.,* Litigation Release No. 12539 (July 12, 1990), 46 SEC Docket 1242.

[10]*SEC v. Wellshire Securities, Inc.,* Litigation Release No. 12411 (March 14, 1990), 45 SEC Docket 1477.

[11]*SEC v. Leonard M. Tucker,* Litigation Release No. 12307 (November 27, 1989), 44 SEC Docket 2364.

[12]*SEC v. Lifeline Healthcare Group, Ltd.,* Litigation Release No. 12300 (November 21, 1989), 44 SEC Docket 2236.

[13]*SEC v. Arnold Kimmes,* Litigation Release No. 12210 (August 9, 1989), 44 SEC Docket 507.

[14]*SEC v. Suzanne Bosworth,* Litigation Release No. 12580 (August 15, 1990), 46 SEC Docket 1780.

[15]*SEC v. San Marino Securities, Inc.,* Litigation Release No. 12644 (September 28, 1990), 47 SEC Docket 772; *see also In the Matter of San Marino Securities, Inc.,* Securities Exchange Act Release No. 28486 (September 28, 1990), 47 SEC Docket 674.

[16]*SEC v. Beres Industries, Inc.,* Litigation Release No. 12575 (August 9, 1990), 46 SEC Docket 1711.

[17]*SEC v. Drexel Burnham Lambert, Inc.,* Litigation Release No. 11859 (September 7, 1988), 41 SEC Docket 1294.

[18]*SEC v. Michael R. Milken,* Litigation Release No. 12454 (April 24, 1990), 46 SEC Docket 145.

[19]*SEC v. Salim B. Lewis,* Litigation Release No. 12569 (August 6, 1990), 46 SEC Docket 1703.

[20]*SEC v. GAP Corporation and James T. Sherwin,* Litigation Release No. 12401 (March 8, 1990), 45 SEC Docket 1384.

[21]*In the Matter of James T. Melton,* Securities Exchange Act Release No. 28313 (August 6, 1990), 46 SEC Docket 1636.

[22]*SEC v. Michael Kaufman,* Litigation Release No. 12425 (March 27, 1990), 45 SEC Docket 1731.

[23]*SEC v. Novaferon Labs, Inc.,* Litigation Release No. 12577 (August 14, 1990), 46 SEC Docket 1774.

[24]*SEC v. Steven L. Glauberman,* Litigation Release No. 12574 (August 9, 1990), 46 SEC Docket 1709.

[25]*SEC v. Saul Bluestone,* Litigation Release No. 12589 (August 22, 1990), 46 SEC Docket 1865.

[26]*SEC v. James H. O'Hagan,* Litigation Release No. 12344 (January 10, 1990), 45 SEC Docket 610.

[27]*SEC v. Alan C. Goulding,* Litigation Release No. 12500 (June 5, 1990), 46 SEC Docket 799; *see SEC v. Morion S. Neiman,* Litigation Release No. 12455 (April 24, 1990), 46 SEC Docket 153 (related case).

[28]*SEC v. Richard H. Towle,* Accounting and Auditing Enforcement Release No. 258 (May 24, 1990), 46 SEC Docket 519.

[29]*SEC v. Barry J. Minkow,* Litigation Release No. 12579 (August 15, 1990), 46 SEC Docket 1777.

[30]*SEC v. Fluid Corporation,* Litigation Release No. 12661 (October 9, 1990), 47 SEC Docket 877.

[31]*SEC v. Rajiv P. Mehta,* Accounting and Auditing Enforcement Release No. 271 (September 10, 1990), 47 SEC Docket 188.

[32]*SEC v. Crowell & Co., Inc.,* Accounting and Auditing Enforcement Release No. 277 (September 28, 1990), 47 SEC Docket 771.

[33]*SEC v. Malibu Capital Corporation,* Litigation Release No. 12635 (September 26 1990), 47 SEC Docket 651.

[34]*In the Matter of Stephen L. Hochberg, CPA,* Accounting and Auditing Enforcement Release No. 251 (January 11, 1990), 45 SEC Docket 565.

[35]*In the Matter of Charles C. Lehman, Jr., CPA,* Accounting and

Auditing Enforcement Release No. 275 (September 28, 1990), 47 SEC Docket 665.

[36]*In the Matter of William G. Gaede, Jr., CPA,* Accounting and Auditing Enforcement Release No. 274 (September 26, 1990), 47 SEC Docket 582.

[37]*In the Matter of Georgia McCarley,* Accounting and Auditing Enforcement Release No. *267* (August 1, 1990), 46 SEC Docket 1534.

[38]*In the Matter of Bruce T. Andersen, CPA,* Accounting and Auditing Enforcement Release No. 268 (August 31, 1990), 46 SEC Docket 2013.

[39]*In the Matter of Charles V. Moore, CPA,* Accounting and Auditing Enforcement Release No. 264 (July *17, 199*0), 46 SEC Docket 1276.

[40]*SEC v. Nortek, Inc.,* Litigation Release No. 12406 (March 12, 1990), 45 SEC Docket 1471.

[41]*SEC v. Edward P. Evans,* Litigation Release No. 12315 (December 6, 1989), 45 SEC Docket 73.

[42]*SEC v. Alan E. Clore,* Litigation Release No. 12377 (February 13, 1990), 45 SEC Docket 1114.

[43]*SEC v. Thomas Lee Oakes,* Litigation Release No. 12451 (April 23, 1990), 46 SEC Docket 140.

[44]*SEC v. Mesa Limited Partnership and T. Boone Pickens Jr.*, Litigation Release No. 12637 (September 27, 1990), 47 SEC Docket 653.

[45]*SEC v. American Assurance Underwriters Group, Inc.,* Litigation Release No. 12334 (January 4, 1990), 45 SEC Docket 508.

[46]*SEC v. Charles A. Oglebay,* Litigation Release No. 12615

(September 12, 1990), 47 SEC Docket 193.

[47]*SEC v. RL Kotrozo, Inc.,* Litigation Release No. 12385 (February 22, 1990), 45 SEC Docket 1175.

[48]*SEC v. Donald Bader,* Litigation Release No. 12584 (August 16, 1990), 46 SEC Docket 1785.

[49]*SEC v. ALIC Corp.,* Litigation Release No. 12419 (March 22, 1990), 45 SEC Docket 1661.

[50]*SEC v. William A. Thorns,* Litigation Release No. 12286 (October 27, 1989), 44 SEC Docket 1969.

[51]*SEC v. Profit Enterprises Inc.,* Litigation Release No. 12588 (August 21, 1990), 46 SEC Docket 1864.

[52]*SEC v. Transwestern Oil & Gas Co., Inc.,* Litigation Release No. 12518 (June 20, 1990), 46 SEC Docket 967.

[53]*SEC v. Thomas Hydrocarbons, Inc.,* Litigation Release No. 12524 (June 28, 1990), 46 SEC Docket 1075.

[54]*In the Matter of The Stuart-James Co. Inc.*, Securities Exchange Act Release No. 26700 (April 5, 1989), 43 SEC Docket 966.

[55]*SEC v. Thomas James Associates, Inc.,* Litigation Release No. 12431 (March 29, 1990), 45 SEC Docket 1740.

[56]*In the Matter of George Salloum,* Securities Exchange Act Release No. 28489 (September 28, 1990), 47 SEC Docket 685.

[57]*SEC v. Oscar Ayala,* Litigation Release No. 12494 (June 1, 1990), 46 SEC Docket 793.

[58]*In the Matter of Walter F. Kusay, Jr.,* Securities Exchange Act Release No. 27945 (April 25, 1990), 46 SEC Docket 99.

[59]*SEC v. HA. Kenning Investments, Inc., and Harry A. Kenning, Jr.,* Litigation Release No. 12534 (July 6, 1990), 46 SEC Docket 1237.

[60]*In the Matter of Harry A. Kenning, Jr.,* Securities Exchange Act Release No. 28230 (July 18, 1990), 46 SEC Docket 1318.

[61]*SEC v. Bruce Black,* Litigation Release No. 12511 (Junel3, 1990), 46 SEC Docket 869.

[62]*SEC v. Phoenix Aviation, Inc.,* Litigation Release No. 12483 (May 22, 1990), 46 SEC Docket 518.

[63]*In the Matter of Alan R. Asker,* Securities Exchange Act Release No. 28483 (September 29, 1990), 47 SEC Docket 664.

[64]*SEC v. Jeffers Investments Corporation,* Litigation Release No. 12365 (February 1, 1990), 45 SEC Docket 915.

[65]*In the Matter of David K. Jeffers and Jeffers Investments Corporation,* Securities Exchange Act Release No. 28135 (June 19, 1990), 46 SEC Docket 912.

[66]*In the Matter of V.F. Minion Securities, Inc., and Vernon F. Minton,* Securities Exchange Act Release No. 28457 (September 21, 1990), 47 SEC Docket 552.

[67]*SEC v. Frank Clarke and Co., Inc.,* Litigation Release No. 12505 (June 7, 1990), 46 SEC Docket 828.

[68]*In the Matter of Frank Clarke and Co., Inc.,* Securities Exchange Act Release No. 28103 (June 11, 1990), 46 SEC Docket 828.

[69]*In the Matter of Stotler and Company,* Securities Exchange Act Release No. 28360 (August 21, 1990), 46 SEC Docket 1816.

[70]*In the Matter of Donaldson, Lufkin & Jenrette Securities Corporation,* Securities Exchange Act Release No. 27889 (April 11, 1990), 45 SEC Docket 1826.

[71]*In the Matter of Gary* W. *Chambers,* Securities Exchange Act Release No. 27298 (September 27, 1989), 44 SEC Docket 1336.

[72]*In the Matter of Goodrich Securities, Inc.,* Securities Exchange Act Release No. 28141 (June 25, 1990), 46 SEC Docket 975.

[73]*SEC v. Michael S. Douglas,* Litigation Release No. 12303 (November 22, 1989),

[74]44 SEC Docket 2240.

[75]*SEC v. Gregory D. Govan,* Litigation Release No. 12322 (December 13, 1989)

[76]45 SEC Docket 190.

[77]*In the Matter of Liberty Securities Group, Inc. and Gregory D. Govan,* Investment Advisers Act Release No. 1232 (June 1, 1990), 46 SEC Docket 789.

[78]*SEC v. U.S. General Corporation,* Litigation Release No. 12304 (November 22, 1989), 44 SEC Docket 2241.

[79]*In the Matter of Blue Chip Market Advisor, Inc. and James Paul Azzalino,* Investment Advisers Act Release No. 1207 (October *25, 198*9), 44 SEC Docket 1832.

[80]*In the Matter of Fred Alger Management, Inc.,* Investment Advisers Act Release No. 1222 (February 26, 1990), 45 SEC Docket 1272.

[81]*SEC v. William P. Dillon,* Litigation Release No. 12531 (July 5, 1990), 46 SEC Docket 1181.

[82]*In the Matter of Patterson Capital Corp. and Joseph B. Patterson,* Investment Advisers Act Release No. 1235 (June 25, 1990), 46 SEC Docket 1057.

[83]*In the Matter of Stein Roe & Farnham Incorporated,* Investment Advisers Act Release No. 1217 (January 22, 1990), 45 SEC Docket 784.

[84]*In the Matter of Thomson McKinnon Asset Management L. P.,* Investment Advisers Act Release No. 1243 (July 26, 1990), 46 SEC Docket 1482.

[85]*SEC v. R.E.C. Investors, Inc.,* Litigation Release No. 12622 (September 18, 1990), 47 SEC Docket 537.

[86]*SEC v. Municipal Lease Securities Fund, Inc.,* Litigation Release No. 12331 (December 26, 1989), 45 SEC Docket 420.

[87]*SEC v. Dart Group Corporation,* Litigation Release No. 12392 (February 28, 1990), 45 SEC Docket 1288.

[88]*SEC v. Fluid Corporation,* Litigation Release No. 12661 (October 9, 1990), 47 SEC Docket 877.

[89]Figures are approximate.

[90]The 1990 total for SEC Requests to Foreign Governments is composed of: 173 Enforcement Assistance Requests; 2 Enforcement Referrals; and 2 Technical Assistance Requests. Prior to 1990, separate totals for enforcement referrals and technical assistance requests were not maintained.

[91]The 1990 total for Foreign Requests to the SEC is composed of: 89 Enforcement Assistance Requests; 2 Enforcement Referrals; and 30 Technical Assistance Requests. Prior to 1990, separate totals for enforcement referrals and technical assistance requests were not maintained.

[92]*See, e.g.,* SEC, Division of Market Regulation, *The October 1987 Market Break* (February 1988).

[93]Market Reform Act of 1990, Pub. L. No. 101-432 (1990).

[94]Division of Market Regulation, SEC, *Trading Analysis of October 13 and 16, 1989* (May 1990).

[95]Securities Exchange Act Release No. 27370 (October 23, 1989), 44 SEC Docket 1732.

[96]*See* Securities Exchange Act Release No. 27445 (November 16, 1989), 44 SEC Docket 2037.

[97]Securities Exchange Act Release No. 27975-A (May 30, 1990), 46 SEC Docket 0543.

[98]Securities Exchange Act Release No. 27956 (April 27, 1990), 46 SEC Docket 0182.

[99]File No. SR-NASD-90-49; File No. SR-NASD-90-50.

[100]Securities Exchange Act Release No. 28146 (June 26, 1990), 46 SEC Docket 0985.

[101]Securities Exchange Act Release No. 26870 (May 26, 1989), 43 SEC Docket 1793.

[102]*See e.g.,* letter from Richard C. Breeden, Chairman, Securities and Exchange Commission, to Ivers W. Riley, Senior Executive Vice President, American Stock Exchange, dated October 17, 1990.

[103]Securities Exchange Act Release Nos. 28285 (July 30, 1990), 46 SEC Docket 1517, and 27851 (March 27, 1990), 45 SEC Docket 1692.

[104]Securities Exchange Act Release Nos. 27598 (January 9, 1990), 45 SEC Docket 554, and 277809 (March 16, 1990), 45 SEC Docket 1502.

[105]Securities Exchange Act Release No. 28518 (October 5, 1990), 47 SEC Docket 805.

[106]Securities Exchange Act Release No. 27902 (April 12, 1990), 45 SEC Docket 1877.

[107]Securities Exchange Act Release No. 27858 (March 28, 1990), 45 SEC Docket 1696.

[108]Securities Exchange Act Release Nos. 27958, 59 (April 27, 1990), 46 SEC Docket 192,93.

[109]Securities Exchange Act Release No. 27959 (April 27, 1990), 46 SEC Docket 193.

[110]Letter from Jonathan Kallman, Assistant Director, Division of Market Regulation, SEC, to Karen Saperstein, Associate General Counsel, ISCC, dated September 13, 1988.

[111]International Series Release No. 137 (August 8, 1990), 46 SEC Docket 1715.

[112]Securities Exchange Act Release No. 28609, International Series Release No. 189 (November 9, 1990), 47 SEC Docket 1361.

[113]Securities Exchange Act Release No. 27554 (December 20, 1989), 45 SEC Docket 213.

[114]Securities Exchange Act Release No. 27967 (May 1, 1990), 46 SEC Docket 46.

[115]Securities Exchange Act Release No. 27877 (April 4, 1990), 45 SEC Docket 1775.

[116]Letter from Jonathan Kallman, Assistant Director, Division of Market Regulation, SEC, to Karen L. Saperstein, Associate General Counsel, ISCC, dated March 12, 1990.

[117]Letter from Jonathan Kallman, Assistant Director, Division of Market Regulation, SEC, to Karen L. Saperstein, Associate General

Counsel, ISCC, dated August 14, 1990.

[118]Securities Exchange Act Release No. 27565 (December 22, 1989), 45 SEC Docket 300.

[119]Securities Exchange Act Release Nos. 27769 (March 6, 1990), 45 SEC Docket 1318,28399 (August 30, 1990), 46 SEC Docket 1907, and 28106 0une 12, 1990), 46 SEC Docket 0832.

[120]Securities Exchange Act Release No. 28544 (October 16, 1990), 47 SEC Docket 909.

[121]Letter from Richard Ketchum, Director, Division of Market Regulation, SEC, to Patrick Mordacq, Secretary General, COB, dated September 18, 1990; and Letter from Patrick Mordacq, Secretary General, COB, to Richard Ketchum, Director, Division of Market Regulation, SEC, dated September 18, 1990.

[122]Securities Exchange Act Release No. 28475 (September 27, 1990), 47 SEC Docket 0595.

[123]Letter from Richard G. Ketchum, Director, Division of Market Regulation, SEC, to Joanne T. Medero, General Counsel, CFTC, dated January 8, 1990.

[124]Securities Exchange Act Release No. 28282 (July 30, 1990), 46 SEC Docket 1509.

[125]Securities Exchange Act Release No. 28553 (October 18, 1990), 47 SEC Docket 0919.

[126]Securities Exchange Act Release No. 28580 (October 25, 1990), 47 SEC Docket 1078.

[127]Securities Exchange Act Release No. 27600 January 9, 1990), 45 SEC Docket 558.

[128]Securities Exchange Act Release No. 27633 (January 18, 1990),

45 SEC Docket 661.

[129]Securities Exchange Act Release No. 27599 (January 9, 1990), 45 SEC Docket 555.

[130]Securities Exchange Act Release No. 27378 (October 24, 1989), 44 SEC Docket 1746.

[131]Securities Exchange Act Release Nos. 28322 (August 9, 1990), 46 SEC Docket 1658, and 28088 (June 1, 1990), 46 SEC Docket 0709.

[132]Securities Exchange Act Release No. 28411 (September 6, 1990), 46 SEC Docket 2038.

[133]Securities Exchange Act Release No. 26870 (May 26, 1989), 43 SEC Docket 1793.

[134]Securities Exchange Act Release No. 28021 (May 16, 1990), 46 SEC Docket 0389.

[135]Securities Exchange Act Release No. 27631 (January 17, 1990), 45 SEC Docket 656.

[136]Securities Exchange Act Release No. 28160 (June 28, 1990), 46 SEC Docket 1015.

[137]Securities Exchange Act Release Nos. 27365 (October 25, 1989), 44 SEC Docket 1643, and 27368 (October 19, 1989), 44 SEC Docket 1647.

[138]Securities Exchange Act Release No. 27280 (September 29, 1989), 44 SEC Docket 1229.

[139]Securities Exchange Act Release No. 27786 (March 8, 1990), 45 SEC Docket 1341.

[140]Securities Exchange Act Release No. 27786 (March 8, 1990), 45 SEC Docket 1341.

[141]15 U.S.C. 78bb(e).

[142]Pub. L. No. 93-406, 88 Stat. 832 (September 2,1974).

[143]Lefter from Richard G. Ketchum, Director, Division of Market Regulation, SEC, to Charles Lerner, Director of Enforcement, DOL (July 25, 1990).

[144]Letter from Richard G. Ketchum, Director, Division of Market Regulation, SEC, to Richard B. Smith, Esq., Davis Polk & Wardwell, dated September 4, 1990.

[145]15 U.S.C. 78f(a).

[146]15U.S.C. 78o(b).

[147]15U.S.C. 78q-1(c).

[148]Letter from John Polanin, Jr., Branch Chief, Financial Institution Regulation, Office of Chief Counsel, Division of Market Regulation, SEC, to Anthony J. Leitner, Goldman, Sachs & Co., dated September 6, 1990.

[149]Letter from John Polanin, Jr., Branch Chief, Financial Institution Regulation, Office of Chief Counsel, Division of Market Regulation, SEC, to George Brunelle, M. C, Harrison & Company, dated September 6, 1990.

[150]Letter from Robert L. D. Colby, Chief Counsel, Division of Market Regulation, SEC, to Richard B. Smith, Esq., Davis Polk & Wardwell (October 4, 1990).

[151]Letter from Robert L. D. Colby, Chief Counsel, Division of Market Regulation, SEC, to Frank J. Wilson, Executive Vice President, Law & Regulatory Policy, NASD, dated December 5, 1989.

[152]Letter from John Polanin, Jr., Special Counsel, Office of Chief

Counsel, Division of Market Regulation, SEC, to Frank J. Wilson, Executive Vice President, Law & Regulatory Policy, NASD, dated August 16, 1990.

[153]Letter regarding Aktiebolaget Volvo and Procordia Aktiebolag dated April 20, 1990.

[154]Letter regarding Attwoods PLC dated June 26, 1990.

[155]Letter regarding Atlas Copco AB dated May 22, 1990.

[156]Letter regarding Hutamaki Oy dated June 7, 1990.

[157]Letter regarding Compagnie General d'Electricite dated July 16, 1990. *See also* Letter regarding U.K. Water Privatization dated November 22, 1989.

[158]Securities Exchange Act Release No. 28561 (October 16, 1990), 47 SEC Docket 979.

[159]Securities Exchange Act Release No. 27938 (April 23, 1990), 46 SEC Docket 90.

[160]Letter from Jonathan G. Katz, Secretary, SEC, to the Hon. Christopher J. Dodd, U.S. Senate (September 10, 1990), transmitting Report of the Division of Market Regulation of the Securities and Exchange Commission on a Proposed Industry Amendment to Section 11 (a) of the Securities Exchange Act of 1934, dated September 10, 1990.

[161]15 U.S.C. 78k(a).

[162]Securities Exchange Act Release No. 28347 (August 15, 1990), 46 SEC Docket 1747.

[163]Letter from Michael A. Macchiaroli, Assistant Director, Division of Market Regulation, SEC, to Salvatore A. Pallante, Senior Vice President, New York Stock Exchange, dated January 31, 1990.

[164]Letter from Michael A. Macchiaroli, Assistant Director, Division of Market Regulation, SEC, to Jeffrey C. Bernstein, Co-Chairman, Compliance Committee, International Operation Association, Securities Industry Association, dated August 9, 1990.

[165]Securities Exchange Act Release Nos. 27382 (October 26, 1989), 44 SEC Docket 1777, and 27383 (October 26, 1989), 44 SEC Docket 1789.

[166]Securities Exchange Act Release No. 27384 (October 26, 1989), 44 SEC Docket 1795.

[167]Securities Exchange Act Release No. 27455 (November 22, 1989), 44 SEC Docket 2170.

[168]Securities Exchange Act Release No. 27846 (March 26, 1990), 45 SEC Docket 1682.

[169]Securities Exchange Act Release No. 27803 (March 14, 1990), 45 SEC Docket 1431.

[170]Securities Exchange Act Release No. 27675 (February 5, 1990), 45 SEC Docket 964.

[171]Securities Exchange Act Release Nos. 27753 (March 1, 1990), 45 SEC Docket 1219, and 28217 (July 18, 1990), 46 SEC Docket 1288.

[172]Securities Exchange Act Release Nos. 28072 (May 30, 1990), 46 SEC Docket 582, and 28143 (June 25, 1990), 46 SEC Docket 980.

[173]Securities Exchange Act Release No. 28293 (August 1, 1990), 46 SEC Docket 1542.

[174]Securities Exchange Act Release No. 27554 (December 20, 1989), 45 SEC Docket 213.

[175]*The Business Roundtable v. Securities and Exchange*

Commission, Fed. Sec. L. Rep. (CCH) 95,291 (D.C. Cir. June 12, 1990).

[176]Securities Exchange Act Release Nos. 27625 (January 16, 1990), 45 SEC Docket 642, and 27466 (November 22, 1989), 44 SEC Docket 2183.

[177]Securities Exchange Act Release No. 27727 (February 22, 1990), 45 SEC Docket 1138.

[178]Securities Exchange Act Release No. 28014 (May 14, 1990), 46 SEC Docket 374.

[179]Securities Exchange Act Release No. 27543 (December 15, 1989), 45 SEC Docket 197.

[180]Securities Exchange Act Release Nos. 27878 (April 4, 1990), 45 SEC Docket 1776; 27702 (February 12, 1990), 45 SEC Docket 1058; and 28003 (May 8, 1990), 46 SEC Docket 318.

[181]Securities Exchange Act Release No. 27837 (March 22, 1990), 45 SEC Docket 1565.

[182]Securities Exchange Act Release No. 28167 (June 29, 1990), 46 SEC Docket 1084.

[183]Securities Exchange Act Release No. 27967 (May 1, 1990), 46 SEC Docket 211.

[184]Securities Exchange Act Release No. 28335 (August 13, 1990), 46 SEC Docket 1737.

[185]Securities Exchange Act Release No. 27561 (December 21, 1989), 45 SEC Docket 221.

[186]Securities Exchange Act Release No. 27981 (May 2, 1990), 46 SEC Docket 240.

[187]Securities Exchange Act Release No. 28040 (May 22, 1990), 46 SEC Docket 453.

[188]Securities Exchange Act Release Nos. 28001 (May 7, 1990), 46 SEC Docket 316; 28191 (July 10, 1990), 46 SEC Docket 1192; and 28242 (July 20, 1990), 46 SEC Docket 1415.

[189]Securities Exchange Act Release No. 27489 (November 30, 1989), 44 SEC Docket 2314.

[190]Securities Exchange Act Release No. 27732 (February 26, 1990), 45 SEC Docket 1185.

[191]Securities Exchange Act Release No. 28277 (July 27, 1990), 46 SEC Docket 1506.

[192]Securities Exchange Act Release No. 27502 (December 5, 1989), 45 SEC Docket 26.

[193]Securities Exchange Act Release No. 27755 (March 1, 1990), 45 SEC Docket 1223.

[194]Securities Exchange Act Release No. 27664 (January 31, 1990), 45 SEC Docket 840.

[195]Securities Exchange Act Release No. 28307 (August 2, 1990), 46 SEC Docket 1552.

[196]Securities Exchange Act Release No. 27752 (March 1, 1990), 45 SEC Docket 1216.

[197]Securities Exchange Act Release No. 28049 (May 24, 1990), 46 SEC Docket 467.

[198]Securities Exchange Act Release No. 28081 (June 1, 1990), 46 SEC Docket 0696.

[199]Rule 19d-1 authorizes certain SROs to report certain technical

violations quarterly in chart form. In fiscal year 1990, the number of cases reported in this abbreviated format was as follows: American Stock Exchange—6, New York Stock Exchange—90, Pacific Stock Exchange-12, and the Philadelphia Stock Exchange-108. These cases are included in the text discussion and chart.

[200]Investment Company Act Release No. 17534 (June 15, 1990), 46 SEC Docket 875.

[201]Investment Company Act Release No. 17589 (July 17, 1990), 46 SEC Docket 1247.

[202]Investment Company Act Release No. 17682 (August 9, 1990), 46 SEC Docket 1830.

[203]Investment Company Act Release No. 17681 (August 17, 1990), 46 SEC Docket 1828.

[204]Investment Company Act Release No. 17769; International Series Rel. No. 160; File No. S717-90 (October 1, 1990), 47 SEC Docket 0746.

[205]Holding Company Act Release No. 25058 (March 19, 1990), 45 SEC Docket 1577.

[206]Holding Company Act Release No. 25059 (March 19, 1990), 45 SEC Docket 1582.

[207]Investment Company Act Release No. 17613 (July 25, 1990), 46 SEC Docket 1466 (Notice); Investment Company Act Release No. 17809 (Oct. 19, 1990), 47 SEC Docket 1098 (Order).

[208]Investment Company Act Release No. 17617 (July 26, 1990), 46 SEC Docket 1476 (Notice); Investment Company Act Release No. 17673 (Aug. 14, 1990), 46 SEC Docket 1765 (Order).

[209]Investment Company Act Release No. 17404 (April *1, 199*0), 45 SEC Docket 1784 (Notice and Temporary Order); Investment

Company Act Release No. 17404A (April 11, 1990), 45 SEC Docket 1892 (Corrected Notice and Temporary Order); Investment Company Act Release No. 17501 (May 21, 1990), 46 SEC Docket 496 (Permanent Order).

[210]'Capital Preservation Fund, Inc. (pub. avail. September 11, 1990).

[211]Sanford C. Bernstein Fund, Inc. (pub. avail. June 25, 1990).

[212]Nuveen Advisory Corp. (pub. avail. September 4, 1990).

[213]Scudder Group of Funds (pub. avail. June 19, 1990).

[214]Zweig Series Trust (pub. avail. January 10, 1990).

[215]Bennett Management Co. (pub. avail. February 26, 1990).

[216]Rosenberg Institutional Equity Management (pub. avail. March 14, 1990).

[217]Holding Company Act Release No. 25136 (August 27, 1990), 46 SEC Docket 1911.

[218]Holding Company Act Release No. 25100 (June 5, 1990), 46 SEC Docket 0737.

[219]Holding Company Act Release No. 24590 (February 26, 1988), 40 SEC Docket 634.

[220]*Wisconsin's Environmental Decade, Inc. v. SEC,* 882 F.2d 523 (D.C. Or. 1989).

[221]Holding Company Act Release No. 25096 (May 25, 1990), 46 SEC Docket 0586.

[222]Holding Company Act Release No. 25032 (February 2, 1990), 45 SEC Docket 1004.

[223]Holding Company Act Release No. 24911 (June 29, 1989), 43 SEC Docket 2278.

[224]Holding Company Act Release No. 24911 (June 29, 1989), 43 SEC Docket 2278.

[225]Holding Company Act Release No. 25152 (September 18, 1990), 47 SEC Docket 0480.

[226]Pacific Mutual Life Insurance Company (pub. avail. August 31, 1990).

[227]Great-West Life & Annuity Insurance Company (pub. avail. August 23, 1990).

[228]Registration Forms for Insurance Company Separate Accounts that Offer Variable Annuity Contracts, Investment Company Act Release No. 14575 (June 25, 1985), 33 SEC Docket 508.

[229]College Retirement Equities Fund (pub. avail. Mar. 2, 1990).

[230]Securities Exchange Act Release No. 27425 (November 7, 1989), 44 SEC Docket 1982.

[231]Securities Exchange Act Release No. 27671 (February 2, 1990), 45 SEC Docket 925.

[232]Securities Act Release No. 6863 (April 24, 1990), 46 SEC Docket 40.

[233]Securities Act Release No. 6879 (October 23, 1990), 47 SEC Docket 979.

[234]Securities Act Release No. 6862 (April 23, 1990), 46 SEC Docket 23.

[235]Securities Act Release No. 6862 (April 23, 1990), 46 SEC Docket 23.

[236]Securities Exchange Act Release No. 28093 (June 6, 1990), 46 SEC Docket 655.

[237]Securities Act Release No. 6869 (June 22, 1990), 46 SEC Docket 892.

[238]Securities Act Release No. 6867 (June 6, 1990), 46 SEC Docket 659.

[239]1989 Annual Report at p. 29.

[240]Testimony of Richard C. Breeden, Chairman, SEC, Concerning Issues Involving Financial Institutions and Accounting Principles before the Senate Committee on Banking, Housing and Urban Affairs, September 10, 1990 at 32.

[241]Staff Accounting Bulletin No. 87 (December 12, 1989), 45 SEC Docket 192 (Property-Casualty Insurance Reserves for Unpaid Claims Costs; Contingency Disclosure).

[242]Staff Accounting Bulletin No. 88 (August 10, 1990), 46 SEC Docket 1787 (Disclosures Required of Foreign Private Issuers to Comply with Item 17 of Form 20-F).

[243]Securities Exchange Act Release No. 33-6789 (July 19, 1988), 41 SEC Docket 681.

[244]H.R. 5269,101st Cong., 2d Sess. (1990).

[245]Securities Exchange Act Release No. 33-6837 (June 20, 1989) 43 SEC Docket 2080.

[246]Proposed Statement on Auditing Standards, Communication of Matters about Interim Financial Information Filed or to be Filed with Specified Regulatory Agencies (June 1990).

[247]Proposed Statement on Auditing Standards, Omnibus Statement

on Auditing Standards – 1990 (July 1990).

[248]Financial Reporting Release No. 28 (December 1, 1986), 37 SEC Docket 194.

[249]Practice Bulletin No. 7, Criteria for Determining Whether Collateral for a Loan Has Been In-Substance Foreclosed (April 1990).

[250]ASC Statement of Intent, Comparability of Financial Statements *(July* 1990)

[251]903 F.2d 75 (2d Cir.), *rehearing en banc granted,* [Current] Fed. Sec. L. Rep. (CCH) 195,439 (2d Cir. 1990).

[252]915 F.2d 439 (9th Cir. 1990).

[253]910 F.2d 1028 (2d Cir.), *petition for rehearing denied,* 917 F.2d 98 (2d Cir. 1990).

[254]110 S.Ct. 945 (1990).

[255]328 U.S. 293 (1946).

[256]18 F.2d 349 (2d Cir. 1990).

[257]854 F.2d 1319 (5th Cir. 1988), *cert, denied,* 109 S.Ct. 3214 (1989).

[258]No. 90-333 (S.Ct.).

[259]909 F.2d 724 (2d Cir. 1990), *petition for cert, granted,* 111 S.Ct. 669 (1991).

[260]914 F.2d 1564 (9th Cir. 1990), *cert, denied,* 111 S. Ct. 1621 (1991).

[261]905 F.2d 406 (D.C. Cir. 1990).

[262]883 F.2d 525 (7th Cir. 1989).

[263]470 U.S. 821(1985).

[264]923 F.2d 1270 (7th Cir. 1991).

[265]895 F.2d 1272 (9th Cir. 1990).

[266]111 S.Ct. 415 (1990).

[267]888 F.2d 1537 (11th Cir. 1989)

[268]No. 89-1448 (S.Ct.).

[269]*Price Waterhouse v. SEC,* No. 90-0245 (D.D.C. 1990).

[270]*Safecard v. SEC,* No. 84-3073 (D.D.C. 1989) *appeal pending,* No. 89-5374 (D.C. Or. 1990).

[271]*Phoenix Central and Arizona, General Partnership v. SEC,* Docket No. M90-001 PHX RG5 (D. Ariz. March 1, 1990); *Recorp Northwest Outer Loop Associates, F/K/A Recorp Outer Loop Associates v. SEC,* Docket No. M90-002 PHX CLH (D. Ariz. March 21, 1990); *In the Matter of the U.S. Securities and Exchange Commission Private Investigation /Application of John Doe in re Certain Subpoenas,* Misc. No. M18-304 (VLB) (S.D.N.Y. March 14, 1990); *In re Securities and Exchange Commission Private Investigation/Application of John Doe re Certain Subpoenas,* Misc. No. M8-85 (MBM) [1990 Transfer Binder] Fed. Sec. L. Rep. (CCH) *1*95,424 (S.D.N.Y. August 10, 1990) (two actions); and *In the Matter of the U.S. Securities and Exchange Commission Private Investigation/Application of David R. Yeaman re a Certain Subpoena,* Misc. No. 90-M-86W (D. Utah August 30, 1990) (two actions).

[272]*Kemprowski v. SEC,* C.A. No. 90-3831 (D.N.J.) (motion withdrawn October 24, 1990).

[273]Misc. No. M8-85 (MBM) [1990 Transfer Binder] Fed. Sec. L. Rep. (CCH) f 95,424 (S.D.N.Y. August 10, 1990).

[274]*SEC v. Comserv Corp.,* Nos. 5063MN and 5064MN (8th Or. July 24, 1990); *see also Antonou v. SEC,* Nos. 85-3384/88-1095 (8th Cir. August 14, 1989) (denying as premature *Antonou's* application for attorney's fees after vacating and remanding Commission order on review).

[275]*Hale v. McKenzie,* No. 1:90-CV-1105-GET (N.D. Ga. October 30, 1990).

[276]*SEC v. World-Wide Coin Investments, Inc.,* 567 F. Supp. 724 (N.D. Ga. 1983).

[277]*SEC v. American Assurance Underwriter Group, Inc.,* No. 89-7016-CIV-PAINE (S.D. Fla. March 30, 1990).

[278]*SEC v. Belmont Reid and Company,* No. C-84-6366-JPV (N.D. Cal. November 2, 1990).

[279]*SEC v Belmont Reid and Company,* No.C-84-6366-JPV (N.D.Cal.May 20, 1985), *affd,* 794 F.2d 1388 (9th Cir. 1986).

[280]47 SEC Docket 405 (September 25, 1990).

[281]A.P. No. 3-7038 (September 20, 1989).

[282]*SEC v. The Electronics Warehouse, Inc.,* 689 F. Supp. 53 (D. Conn. J988).

[283]Securities Exchange Act Release No. 28262 (July 25, 1990).

[284]Civ. No. 86-C-0313G (D. Utah).

[285]No. 3-7030 (October 25, 1989). *v. Porto,* Civ. Action No. 88-C-0239 (N.D. 111. 1988).

[286]Securities Exchange Act Release No. 27535 (December 13, 1989), 45 SEC Docket 120.

[287]Investment Advisers Act Release No. 1236 (June 26, 1990), 46 SEC Docket 1062.

[288]Pub. L. No. 101-429,104 Stat. 931 (1990).

[289]Pub. L. No. 101-432,104 Stat. 978 (1990).

[290]Pub. L. No. 101-550,104 Stat. 2713 (1990). *"Request for Public Comments on the Role of the Securities and Exchange Commission in Reorganization Cases under Chapter 11 of the Bankruptcy Code,* Corporate Reorganization Release No. 384, Release No. 34-27300 (September 27, 1989), 54 Fed. Reg. 40760 (October 3, 1989).

[291]*In re Amdura Corporation,* Case No. 90-3811-E et. seq.(Bankr. Colo); *In re Sahlen & Associates, Inc.,* No. 89B11234-44 (Bankr. S.D.N.Y.) (formal request made to U.S. trustee).

[292]*In re The Worthington Company,* No. 89-3279 and No. 89-3286 (6th Cir.).

[293]*In re The Worthington Company,* No. 89-3279 and No. 89-3286 (6th Cir. December *5, 199*0).

[294]*Grogan v. Garner,* No. 89-1149 (S. Ct).

[295]*Grogan v. Garner,* 806 F.2d 829 (8th Cir. 1986).

[296]*Grogan v. Garner,* 111 S. Ct. 654 (1991).

[297]*In re Resorts International, Inc.,* Nos. 89-10119, 89-10120, 89-10461, and 89-10462 (Bankr. D. N. J.).

[298]*Kaiser Steel Corp. v. Charles Schwab & Co.,* 913 F.2d 846 (10th Cir. 1990).

[299]*Kaiser Steel Resources, Inc. v. Action Traders, Inc.,* No. 90-1243 (10th Cir.); *Kaiser Steel Resources, Inc. v. Pearl Brewing Co.,* No. 90-

1245 (10th Cir.).

[300]*In re General Development Corp.,* Case No. 90-1223-BKC-AJC (Bankr. S.D. Ha).

[301]*In re Johns-Mansville Corp.,* 801 F.2d 60 (2d Cir. 1986).

[302]*In re LTV Corp.,* 104 B.R.626 (S.D.N.Y. 1989), *appeal pending,* No. 89-5040 (2d Cir.).

[303]*In re American Reserve,* 840 F.2d 487 (7th Cir. 1988).

[304]*In re The Charter Co.,* 876 F.2d 866 (11th Cir. 1989).

[305]*In re Johns-Manville,* 53 B.R. 346,350-51 (Bankr. S.D.N.Y. 1985).

[306]*In re SIS Corp. and Sisters International Inc.,* Nos. B-89-0800, B-89-081 (Bankr. N.D. Ohio) (two objection filed); *In re American Medical Technology, Inc.,* Case No. 89-0144 (Bankr. W.D. Tex.); and *In re Saratoga Standardbreds, Inc.,* Case No. 88-11973 (DM) (Bankr. N.D.N.Y.).

[307]*In re American Medical Technology, Inc.,* Case No. 89-30144 (Bankr. W.D. Tex.).

[308]*In re Saratoga Standardbreds, Inc.,* Case No. 88-11973 (JJM) (Bankr. N.D.N.Y.).

[309]*In re Southmark Corp.,* Case No. 389-36324-SAF-ll (Bankr. N.D. Tex.).

[310]*In re SIS Corp. and Sisters International, Inc., Bkcy.* Nos. B-89-0800, B-89-081 (Bankr. N.D.O. hbo).

[311]*See, e.g., In re Custom Laboratories, Inc.,* 53rd Annual Report at 74 (objection to disclosure statement); *In re Energy Exchange Corp. and Vulcan Energy Corp.* and *In re Storage Technology Corp.,* 53rd Annual Report at 74-75 (objection to confirmation of reorganization plan).