

# **1995 Annual Report**

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**United States  
Securities and Exchange Commission**

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549**

The Honorable Albert Gore, Jr.  
President of the United States Senate  
Washington, D.C. 20510

The Honorable Newt Gingrich  
Speaker of the House of Representatives  
Washington, D.C. 20515

I am pleased to transmit the annual report of the Securities and Exchange Commission (SEC) for fiscal year 1995. The activities and accomplishments set forth in the annual report continue the Commission's long tradition of hard work and high achievement. I would like to take this opportunity to offer my views of the Commission's progress in addressing several of the major issues facing the Commission.

*Municipal Debt Markets*

In recent years, the Commission and the municipal securities industry have taken several major steps to prepare the debt markets for the twenty-first century. The Municipal Securities Rulemaking Board has effectively severed the link between political campaign contributions and municipal bond underwriting business with its Rule G-37. This rule recently withstood a challenge in the U.S. Court of Appeals, reaffirming industry and regulatory efforts to curtail the insidious practice known as "pay-to-play." In addition, the Commission has undertaken a number of enforcement actions to help

ensure the integrity of this market.

The Commission has also been concerned about inadequate disclosure in the secondary market for municipal securities. In response, industry and issuer groups offered recommendations that were incorporated into Commission rule amendments and will make up-to-date information more readily available.

In addition, the Commission has met with state and local officials throughout our nation in an open dialogue about the prudent management of public funds. We have stressed the importance of safety and liquidity over risk and return as well as the special responsibilities involved in seeking capital through our public markets.

### *Promoting Capital Formation*

Throughout its existence, the Commission has balanced the need for full disclosure and investor protection against the burden that its rules, regulations, and requirements may impose on capital formation. This year, we undertook two fundamental reappraisals of the way the agency regulates. First, an SEC Advisory Committee on Capital Formation and Regulatory Processes was appointed to examine our regulatory approach and consider how it might be improved. The Committee is considering such questions as whether the Commission should register companies instead of securities. The Commission also created an internal Task Force on Disclosure Simplification, which analyzed the cost to companies (in both time and legal fees) of complying with the agency's form and filing requirements. The Task Force reviewed hundreds of forms and regulations and recommended amendment or elimination of many of them. If implemented in its entirety, the report's recommendations would eliminate or modify one-half of the rules and one-fourth of the forms that affect corporate America.

In recent years, the Commission has created a new, simpler registration and disclosure regime for small businesses seeking capital in the securities markets. During 1995, the Commission proposed to allow small businesses to "test the waters" with registered initial public offerings and we shortened the restricted holding periods for privately placed securities under Rule 144. The agency also worked with Congress to craft a "safe harbor" provision in securities litigation reform legislation that might encourage corporations to disclose forward-looking information by protecting them from some of the liability concerns raised by frivolous lawsuits.

### *Disclosure Developments*

The Commission has launched several efforts to simplify and streamline disclosure. In 1995, the Commission worked with the investment company industry and state securities regulators to develop the "profile prospectus," a clear, one-page summary that accompanies the regular prospectus and is designed to give investors a better understanding of the mutual fund they are considering buying. Pilot "profiles" developed by eight fund groups have been available to investors since August 1, 1995.

Toward the same end, the Commission proposed improved disclosure requirements for money market funds. The new standards are designed to simplify money market fund prospectuses considerably, making them less costly to prepare and allowing investors to focus on a short document that contains the most essential information about the fund.

### *Enhancing Investor Protections*

Under the Commission's regulatory scheme, securities firms and self-regulatory organizations serve as the front-line defense against violations of the securities laws. The Commission's enforcement,

examination, and investor education activities back up that defense.

In the past year, the Commission continued its traditionally vigorous enforcement program. Recent notable cases have involved domestic and international insider trading, Ponzi schemes, government securities fraud, misleading disclosures, kickbacks or conflicts of interest related to municipal securities offerings, broker-dealer sales practice abuses, "prime bank notes/" and the relatively new problem of unregistered securities offerings over the Internet.

In May 1995, the Commission consolidated its examination and inspection activities into the Office of Compliance Inspections and Examinations (OCIE). The Commission created OCIE to conduct and coordinate examinations of brokers, dealers, self-regulatory organizations, investment companies and advisers, and transfer agents. One reason the office was created was to enable the SEC to better coordinate its examinations with fellow regulators, and I am pleased to report that we have already reached an important agreement with our colleagues that will reduce duplication of effort for us as well as for the firms we examine.

Working with the industry self-regulatory organizations and state regulators, the Commission also conducted a sales practice sweep of small and medium-sized brokerage firms. The objective of the sweep was to identify problem brokers and to ensure that appropriate supervisory mechanisms are in place and, where necessary, to take appropriate enforcement action.

The Commission's Office of Investor Education and Assistance continued its concerted efforts to reach out to investors. With the help and cooperation of the securities industry and state regulators, the office continued its highly popular investor town meetings to offer tips on how to invest wisely. Other outreach efforts during the year include the creation of an SEC site on the World Wide Web, which

offers corporate financial information from our Electronic Data Gathering, Analysis, and Retrieval System (EDGAR) as well as SEC News Digests, litigation releases, speeches, testimony before Congress, rule proposals, press releases and investor alerts. For those who lack Internet access, the Commission also created a toll-free investor information line.

### *International Listings*

During the year, the agency worked to reduce costs for foreign companies entering the U.S. markets by simplifying the registration and reporting process while maintaining high U.S. disclosure standards. At a time when cross-border listings in other major markets have either hit a plateau or declined, foreign issuer participation in the U.S. markets has grown dramatically in the 1990s—the Commission had a record 738 foreign listings at the beginning of 1996.

I believe that this is one of the most important periods in the Commission's existence. The American corporate community, the securities industry, and our capital markets are changing rapidly. Stocks and bonds are rapidly becoming the investment vehicles of choice for an increasing number of Americans. The Commission—working closely with the Congress, the private sector, and the investors we are bound to serve—is working to meet the challenges posed by these changes. I have every confidence that the Commission will continue to perform its responsibilities with the professionalism and dedication that all of us have come to expect.

Sincerely,

**Arthur Levitt**  
Chairman

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## **Commission Members and Principal Staff Officers**

(As of November 8, 1995)

### **Commissioners\***

**Arthur Levitt**, *Chairman* — Term expires 1998

**Steven M.H. Wallman**, *Commissioner* — Term expires 1997

\*Commissioner J. Carter Beese resigned from the Commission on November 14, 1994, and Commissioner Richard Y. Roberts resigned from the Commission on July 17, 1995.

### **Principal Staff Officers**

**Michael E. Schlein**, *Chief of Staff*

**Linda C. Quinn**, *Director, Division of Corporation Finance*

**Meredith B. Cross**, *Deputy Director*

**William E. Morley**, *Senior Associate Director*

**Abigail Arms**, *Associate Director*

**Robert A. Bayless**, *Associate Director*

**Howard F. Maria**, *Associate Director*

**Mauri L. Osheroff**, *Associate Director*

**Albert S. Dandridge, III**, *Associate Director*

**David A. Sirignano**, *Senior Legal Advisor*

**William R. McLucas**, *Director, Division of Enforcement*

**Colleen P. Mahoney**, *Deputy Director*

**Paul V. Gerlach**, *Associate Director*

**Thomas C. Newkirk**, *Associate Director*  
**Gary N. Sundick**, *Associate Director*  
**Joan E. McKown**, *Chief Counsel*  
**Barry R. Goldsmith**, *Chief Litigation Counsel*  
**Stephen J. Crimmins**, *Deputy Chief Litigation Counsel*  
**George H. Diacont**, *Chief Accountant*  
**James A. Clarkson, III**, *Director of Regional Office Operations*

**Barry Barbash**, *Director, Division of Investment Management*  
**Heidi Stam**, *Associate Director*  
**Vacant**, *Associate Director*  
**Jack Murphy**, *Chief Counsel*

**Brandon Becker**, *Director, Division of Market Regulation*  
**Robert L.D. Colby**, *Deputy Director*  
**Larry E. Bergmann**, *Associate Director*  
**Jonathan Kallman**, *Associate Director*  
**Howard Kramer**, *Associate Director*  
**Michael A. Macchiaroli**, *Associate Director*  
**Catherine McGuire**, *Associate Director/Chief Counsel*  
**Holly Smith**, *Associate Director*

**Simon Lorne**, *General Counsel Office of General Counsel*  
**Paul Gonson**, *Solicitor and Deputy General Counsel*  
**Phillip D. Parker**, *Deputy General Counsel (Legal Policy)*  
**Anne E. Chafer**, *Associate General Counsel*  
**Richard M. Humes**, *Associate General Counsel*  
**Diane Sanger**, *Associate General Counsel*  
**Jacob H. Stillman**, *Associate General Counsel*

**Lori A. Richards**, *Director, Office of Compliance Inspections and Examinations*  
**Mark Fitterman**, *Associate Director*  
**Mary Ann Gadziala**, *Associate Director*

**Gene Gohlke**, *Associate Director*  
**C. Gladwyn Coins**, *Associate Director*

**Paul S. Maco**, *Director, Office of Municipal Securities*

**Michael H. Sutton**, *Chief Accountant, Office of the Chief Accountant*

**Brenda Murray**, *Chief Administrative Law Judge, Office of the  
Administrative Law judges*

**Richard R. Lindsey**, *Chief Economist, Office of Economic Analysis*

**Nancy M. Smith**, *Director, Office of Investor Education and  
Assistance*

**Victor H. Tynes, Jr.**, *Director, Office of Equal Employment  
Opportunity*

**James M. McConnell**, *Executive Director, Office of the Executive  
Director*

**Fernando L. Alegria, Jr.**, *Associate Executive Director*

**Michael Bartell**, *Associate Executive Director*

**Wilson A. Butler, Jr.**, *Associate Executive Director*

**Vacant**, *Associate Executive Director*

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

**Kathryn Fulton**, *Director, Office of Legislative Affairs*

**Jennifer Kimball**, *Director, Office of Public Affairs, Policy Evaluation  
and Research*

**Jonathan G. Katz**, *Secretary of the Commission*

## **Biographies of Commission Members**

### **Arthur Levitt, *Chairman***

Following his nomination by President Clinton and his confirmation by the Senate, Arthur Levitt, Jr. was sworn in as the 25th Chairman of the Securities and Exchange Commission on July 27, 1993.

Before being nominated to the Commission, Mr. Levitt served as the Chairman of the New York City Economic Development Corporation and, from 1978 to 1989, the Chairman of the American Stock Exchange.

Throughout his career, Mr. Levitt has been called upon to serve on many governmental task forces and boards of directors. At the federal level, he has served on four executive branch commissions, including chairing the White House Small Business Task Force from 1978 to 1980. Most recently, he was a member of the President's Base Closure and Realignment Commission and the Defense Department Task Force on the National Industrial Base. In addition to heading the New York City Economic Development Corporation, he chaired the Special Advisory Task Force on the Future Development of the West Side of Manhattan and the Committee on Incentives and Tax Policy of the New York City Mayor's Management Advisory Task Force.

Mr. Levitt has served on 10 corporate and philanthropic boards, including those of the Equitable Life Assurance Society of the United States, East New York Savings Bank, First Empire State Corporation,

the Revson Foundation, the Rockefeller Foundation, the Solomon R. Guggenheim Foundation and Williams College.

Mr. Levitt founded Levitt Media Company in 1986, and served as the company's Chairman. Its primary holding was *Roll Call, the Newspaper of Congress*.

Prior to accepting the Amex chairmanship, Mr. Levitt worked for 16 years on Wall Street. From 1969 to 1978, he was President and Director of Shearson Hayden Stone, Inc. (today Smith Barney) whose predecessor firm he joined as a partner in 1962. It was during this period that Mr. Levitt first involved himself with Amex, becoming one of its governors in 1975 and in 1977 accepting the additional position of Vice Chairman.

From 1959 to 1962, Mr. Levitt worked at the Kansas-based agricultural management firm Oppenheimer Industries, where he rose to the position of Executive Vice President and Director. From 1954 to 1959, Mr. Levitt was assistant promotion director at Time, Inc.

Mr. Levitt 65, graduated Phi Beta Kappa from Williams College in 1952 before serving two years in the Air Force. Married since 1955 to the former Marilyn Blauner, Mr. Levitt has two grown children, Arthur III and Lauri.

**Steven M.H. Wallman, *Commissioner***

Steven M.H. Wallman was nominated to the Securities and Exchange Commission by President Bill Clinton and confirmed by the Senate on June 29, 1994. He was sworn in as a Commissioner on July 5, 1994. His term expires in June 1997.

Before being nominated to the Commission, Mr. Wallman was in private practice with the Washington law office of Covington and

Burling. He joined the firm in 1978 as an Associate, becoming a Partner in 1986. While at Covington & Burling, Mr. Wallman specialized in general corporate, securities, contract and business law. Mr. Wallman also worked for the Boston Consulting Group in 1978. He is a member of the American Law Institute and the American Bar Association.

Mr. Wallman received his J.D. from the Columbia University School of Law in 1978. In 1976, he earned an S.M. from the Sloan School of Management at the Massachusetts Institute of Technology and an S.B. from M.I.T. in 1975. He and his wife live in Great Falls, Virginia. Mr. Wallman was born on November 14, 1953.

## **SEC REGIONAL AND DISTRICT OFFICES**

### **Central Regional Office**

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### **Midwest Regional Office**

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## **Enforcement**

*The Commission's enforcement program is designed to protect investors and foster confidence by preserving the integrity and efficiency of the securities markets. The enforcement program's principal legislative mandates contain explicit authority for the agency to conduct investigations and prosecute violations of the securities laws by bringing enforcement actions in federal court or instituting administrative proceedings before the Commission. Last year, as in prior years, the Commission maintained a strong presence in all areas within its jurisdiction.*

### **Key 1995 Results**

In 1995, the Commission instituted a significant number of enforcement actions in response to a wide range of securities law violations. In its administrative and judicial proceedings, the Commission sought and obtained relief from a broad and flexible array of remedies designed to protect investors and the public interest. Investor complaints and inquiries continued to provide the Commission with information on potential securities fraud and abuse. During 1995, nearly one-fifth of the investigations initiated by the Commission stemmed, in part, from investor complaints.

The Commission obtained court orders requiring defendants to disgorge illicit profits of over \$994 million. Civil penalties authorized by the Securities Enforcement Remedies and Penny Stock Reform Act of 1990 (Remedies Act), the Insider Trading Sanctions Act of 1984 (ITSA), and the Insider Trading and Securities Fraud Enforcement Act of 1988 (ITSFEA) totaled over \$34 million. In some instances, the payment of disgorgement pursuant to a court order was waived based upon the defendant's demonstrated inability to pay. Courts also have noted in some cases that civil penalties were

appropriate but were not imposed because of a demonstrated inability to pay.

[table deleted]

In Commission-related cases, criminal authorities obtained 92 criminal indictments or informations, and 98 convictions during 1995. The Commission granted access to its files to domestic and foreign prosecutorial authorities in 285 instances.

Over 42,500 complaints and inquiries were analyzed and responded to during 1995, an increase of 10 percent over 1994. Approximately 50 percent of the complaints involved broker-dealers, while the remainder involved issuers, mutual funds, banks, transfer and clearing agents, investment advisers, and various financial and non-financial matters. More than 2,900 complaints were referred to the Commission's operating divisions, self-regulatory organizations (SROs), and other regulatory entities for review or action.

### **Enforcement Authority**

The Commission has broad authority to investigate possible violations of the federal securities laws. Informal investigations are conducted on a voluntary basis, with the Commission requesting persons with relevant information to cooperate by providing documents and testifying before SEC 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. Generally, both types of investigations are conducted on a confidential, non-public basis.

Traditionally, one of the Commission's principal enforcement mechanisms for addressing violative conduct has been the federal

court injunction, which prohibits future violations. In civil actions for injunctive relief, 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. Once an injunction has been imposed, conduct that violates the injunction is punishable by either civil or criminal contempt, and violators are 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. 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 Remedies Act authorized the Commission to seek, and the courts to impose, civil penalties for any violation of the federal securities laws (with the exception of insider trading violations for which penalties are available under ITSA and ITSFEA). The Remedies Act also affirmed the existing equitable authority of the federal courts to bar or suspend individuals from serving as corporate officers or directors.

The Commission has the authority to institute several types of administrative proceedings, in addition to civil injunctive actions. The Commission may institute administrative proceedings against regulated entities in which the sanctions that may be imposed include a censure, limitation 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. In addition, individuals participating in an offering of penny stock may be barred by the Commission from such participation. In administrative proceedings against regulated entities and their associated persons, the Remedies Act also authorized the Commission to impose penalties and order disgorgement.

The Remedies Act further authorized the Commission to institute administrative proceedings in which it can issue cease and desist orders. A permanent cease and desist order can be entered against any person violating the federal securities laws, and may require disgorgement of illegal profits. The Commission also is authorized to issue temporary cease and desist orders (if necessary, on an *ex parte* basis) against regulated entities and their associated persons 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 the completion of proceedings.

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) can 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 can be ordered to comply, or to take steps to effect compliance, with the relevant provisions. Pursuant to Rule 102(e) of the Commission's Rules of Practice (former Rule 2(e)), administrative proceedings can be instituted against professionals who appear or practice before the Commission, including accountants and attorneys. The sanctions that can be imposed in these proceedings include suspensions and bars from appearing or practicing before the Commission.

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

Department of Justice for the criminal prosecution of securities violations.

## **Enforcement Activities**

Set forth below are summaries of significant enforcement actions initiated in various areas during 1995. Defendants or respondents who consented to settlements of actions did so without admitting or denying the factual allegations contained in the complaint or order instituting proceedings. See Table 2 for a listing of all enforcement actions instituted in 1995.

### *Offering Cases*

Securities offering 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 from the registration requirements that are not available under the circumstances. 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.

#### *1. Offerings over the Internet*

The Internet and the various commercial on-line computer services have become a popular source of information about many areas of public interest, including securities. In some cases, however, communications over the Internet also have been used to solicit the purchase of unregistered securities or to further securities frauds. In *SEC v. Block*,<sup>1</sup> for example, the Commission alleged that the defendant used the Internet to advance a "prime bank" scheme. (Other prime bank schemes are described below.) Potential investors

were promised that their funds would be doubled in as little as four months and that their investments were guaranteed against loss by a "Prime Bank Guarantee" that would be used as security. In fact, no such prime bank instrument existed, and the defendant failed to disclose the risks associated with the investments, or how the promised returns would be generated. On September 14, 1995, the Commission obtained a preliminary injunction and an asset freeze in these pending proceedings.

The Commission alleged that the defendant in *SEC v. Odulo*,<sup>2</sup> posted a false and misleading solicitation on the Internet seeking investors for a \$500,000 offering of \$1,000 denomination bonds. According to the complaint, the defendant represented that the bonds would yield a "whopping 20% rate of return" and were "a very low risk" investment. The defendant failed to disclose that the proceeds were sought to fund a proposed new venture involving the acquisition and raising of eels, and failed to disclose his lack of expertise in the culturing of eels. To lend credibility to the offering, the defendant created false endorsements of the bonds by fictitious investment advisers and falsely stated that all investments were insured against possible loss. The defendant consented to the entry of an injunction.

In *SEC v. Pleasure Time Inc.*,<sup>3</sup> the defendants allegedly recruited investors for a "multi-level marketing" system by telephone, fax, and postings on the Internet. Investors were told that they could reap enormous profits from a world-wide telephone lottery with projected receipts of \$300 million. The defendants failed to disclose the legal, regulatory, and technical obstacles to starting such a lottery. The Commission obtained a preliminary injunction in this case, and one of the defendants has consented to the entry of an injunction.

## 2. Prime Bank Schemes

Schemes to sell so-called "prime bank" securities continue to appear. The typical case involves the offer and sale of notes, debentures, letters of credit, or guarantees purportedly issued by one or more major international banks. Investors in these schemes are typically promised unrealistic rates of return, e.g., a 150 percent annualized rate of "profits." In *SEC v. Gallard*,<sup>4</sup> the Commission alleged that John Gallard, Adrian Gallard, and their company, The Aberdeen Group, Inc., defrauded investors through their operation of a scheme to sell fraudulent "prime bank" securities. The Commission alleged that, since 1992, defendants defrauded investors of over \$2.3 million in the offer and sale of fictitious securities. Defendants falsely represented that they could obtain debt instruments issued by "top world banks" at a deep discount from face value and could arrange for the resale of the securities at a tremendous profit to investors. In fact, the securities did not exist, and defendants, instead of delivering the securities as promised, simply kept the large deposits they had induced investors to pay, and fabricated defaults by the investors to justify the "forfeiture" of the "refundable" deposits. This action was pending at the end of the year. In *SEC v. Norton*,<sup>5</sup> the Commission charged four individuals with engaging in a fraudulent "prime bank" scheme that resulted in one investor losing \$765,000 and another investor losing \$125,000. According to the complaint, the defendants raised funds from investors by falsely promising them extraordinary profits and a risk-free investment if they deposited funds in an escrow account at a law firm. The investors were told that their funds would be used to facilitate the purchase and sale of prime bank notes supposedly issued by the top banks in the world. In fact, as alleged in the complaint, the investors' funds were misappropriated. These proceedings are pending.

### 3. Telecommunications Cases

The Commission also has filed actions arising from the solicitation of interests in ventures purportedly developing advanced telecommunication technologies. These cases typically arise from the fraudulent, unregistered sale of securities in ventures ostensibly involved in wireless cable, specialized mobile radio, interactive video and data services, and similar telecommunication technologies. While many telecommunications technology companies raise capital through legitimate means, the Commission has uncovered numerous fraudulent ventures, which often take the form of limited liability companies or partnerships that promoters falsely represent as outside the registration provisions of the federal securities laws, and which often are promoted through "infomercials" and high-pressure telephone sales pitches.

The Commission's complaint in *SEC v. United Communications, Ltd.*<sup>6</sup> alleged a scheme that induced approximately 3,000 investors nationwide to invest over \$40 million in "membership units" in limited liability companies that purportedly were developing wireless cable television systems. The defendants used high pressure "boiler room" telemarketing tactics, misrepresented the returns that investors could expect, and omitted to disclose risks. They represented that investors would receive a return of up to 400 percent within a few years, at minimal risk, while using millions of dollars of investor funds for their own purposes. Three individuals and four companies, including United Communications, Ltd., consented to the entry of injunctions. In addition, United Communications and two of the settling individuals agreed to disgorge a total of \$12,334,040. A relief defendant, TechniVision, Inc., also agreed to disgorge \$7 million. This action was pending as to other defendants at the end of the year.

In *SEC v. Future Vision Direct Marketing, Inc.*,<sup>7</sup> the Commission alleged a scheme involving the fraudulent offer and sale of "membership interests" in limited liability companies, and partnership interests in a limited partnership, formed to fund wireless cable television operations in Venezuela. The defendants raised approximately \$3 million from the sale of membership interests in the limited liability companies, and approximately \$310,000 from sales of limited partnership interests. Offering materials failed to disclose material information concerning, among other things, the principals' primary roles in the offerings, loans from the principals to the limited liability companies, and prior criminal and/or civil fraud actions against certain of the defendants. Investor funds also were misappropriated by certain defendants. The Commission obtained a preliminary injunction and an asset freeze in this action, which was pending at the end of the year.

In *SEC v. Telecom Marketing, Inc.*,<sup>8</sup> the Commission alleged that the defendants violated the antifraud and registration provisions of the federal securities laws through the offer and sale of as much as \$28.5 million in investment contracts by Telecom Marketing, Inc. and two other firms. The investment contracts involved are units in two general partnerships formed to invest in wireless cable television systems in Mobile, Alabama and Madison, Wisconsin. The partnership units in question were sold to over 2,600 investors residing throughout the United States at prices ranging from \$3,750 to \$5,450 per unit. Both offerings were sold by a network of boiler rooms. Among other things, the offering materials failed to disclose the relatively low prices paid by the promoters for the assets to be transferred to the partnerships, or the correspondingly large profits to be made by the promoters on the transactions. Finally, the offering materials for both offerings disclosed sales commissions of 15 percent, when in fact the boiler rooms received sales commissions of 50 percent of the funds they raised. The Commission obtained a

preliminary injunction, an asset freeze, and the appointment of a receiver in these pending proceedings.

In *SEC v. Qualified Pensions, Inc.*,<sup>9</sup> the Commission alleged that Qualified Pensions, Inc. (QPI) and Jerry G. Allison misappropriated at least \$4.5 million in retirement savings entrusted to QPI to be maintained in individual retirement accounts (IRA) and other retirement savings plans. More than 14,500 individuals were induced to transfer at least \$270 million of their retirement savings to accounts at QPI, which permitted investors to purchase illiquid, unregistered securities that generally cannot be purchased in IRA accounts at banks or broker-dealers. In addition, promoters of speculative telecommunication technology securities, many of which involve frauds, sent QPI account opening documents to prospective investors along with their own promotional materials, and encouraged investors to invest their retirement savings in the offered securities through QPI. The complaint alleges that at least \$72 million of QPI's customers' funds were invested in telecommunication technology securities. The Commission obtained a preliminary injunction, an asset freeze, and the appointment of a receiver in these pending proceedings.

#### 4. *Other Offering Cases*

The Commission filed an action against Irwin H. "Sonny" Bloch, a "consumer advocate" and radio talk show host, alleging that Bloch and entities under his control defrauded investors of \$3.8 million in connection with the sale of unregistered membership interests in three limited liability companies formed to acquire certain AM radio stations in Florida. In *SEC v. Block*,<sup>10</sup> the Commission alleged, among other things, that the defendants distributed offering materials that contained material misrepresentations and omissions concerning the projected value of an investment, and the projected revenues,

expenses, and growth rate of the radio stations. In addition, Bloch diverted over \$1 million in investor funds to himself and his spouse and to companies under their control. This action was pending at the end of the year.

In *SEC v. Bennett*,<sup>11</sup> the Commission alleged that The Foundation for New Era Philanthropy and John G. Bennett, Jr. engaged in a massive scheme by which hundreds of non-profit organizations, including churches, charities, and universities, were defrauded out of at least \$100 million. The defendants purported to operate an investment program in which non-profit organizations were induced to invest for a period of six months, with promises that they would receive back twice the amount of their investments through a "matching fund" supplied by anonymous benefactors. In fact, there were no benefactors, and New Era was operating a "Ponzi" scheme, in which funds obtained from newer investors were used to meet obligations to prior investors. The Commission obtained a preliminary injunction and an asset freeze in these proceedings, which were pending at the end of the year.

The Commission's action in *SEC v. International Breeders, Inc.*<sup>12</sup> involved the fraudulent sale of unregistered partnership interests in ostrich breeding ventures. The defendants offered the interests through high-pressure, boiler room sales tactics, and raised at least \$6.5 million from over 700 investors. Among other things, the defendants misrepresented to investors that they could receive returns of 500 percent or more. In addition, defendants failed to disclose that ostrich breeding is a high-risk, highly speculative investment, or that many of the defendants had been ordered by several states to cease and desist the offer and sale of ostrich investments. The Commission obtained a preliminary injunction and an asset freeze in these proceedings, which were pending at the end of the year.

In *SEC v. Naiman*,<sup>13</sup> the Commission alleged that Gary F. Naiman, the president of Pioneer Mortgage Company, offered and sold \$238 million of trust deed investments to approximately 2,500 elderly investors without disclosing Pioneer's poor financial condition, the increasing number of borrowers who were defaulting on the loans underlying the trust deeds, or Naiman's diversion of investor funds for unauthorized purposes. Naiman consented to the entry of an injunction and an order requiring him to disgorge \$164,031,701, plus interest.

### *Financial Disclosure*

Actions involving false and misleading disclosures concerning matters that affect the financial condition of an issuer, or involving the issuance of false financial statements, often are complex and, in general, demand more resources than other types of cases. Effective prosecution in this area is essential to preserving the integrity of the full disclosure system. The Commission brought 71 cases containing significant allegations of financial disclosure violations against issuers, regulated entities, or their employees. Many of these cases included alleged violations of the books and records and internal accounting control provisions of the Foreign Corrupt Practices Act. The Commission also brought 11 cases alleging misconduct by accounting firms or their partners or employees,

In *SEC v. First Capital Holdings Corp., Inc.*,<sup>14</sup> the Commission alleged that First Capital made material misrepresentations and omissions concerning the financial condition and results of operations of its subsidiary, First Capital Life Insurance Company (FCL). FCL sought to increase its statutory capital and surplus under reinsurance agreements that did not support the recognition of "reserve credits" under California law; as a result by year-end 1990, First Capital overstated its subsidiaries' consolidated capital and surplus by over

\$65 million. First Capital failed to disclose the negative effect that any reversal of FCL's accounting treatment of reserve credits would have on First Capital's ability to continue as a going concern. First Capital consented to the entry of an injunction. In related proceedings, First Capital's chief financial officer and chief operating officer each consented to the entry of cease and desist orders.

In *SEC v. Softpoint, Inc.*,<sup>15</sup> the Commission alleged that Softpoint's earnings and income from 1992 through 1994 were artificially inflated by the reporting of fictitious software sales in periodic filings and press releases, Softpoint falsely disclosed the generation of \$4.4 million in revenue from certain sales to foreign distributors (certain of which were under the control of Softpoint's former president). In addition, Softpoint issued 420,000 shares of its stock to these foreign distributors, the stock then being sold in the United States purportedly pursuant to Regulation S. Softpoint falsely disclosed that funds received from these stock sales were payments on the receivables from the foreign distributors. Softpoint's president and former president also sold Softpoint stock while in possession of material non-public information about the fraudulent scheme. These proceedings were pending at the end of the year.

The Commission's complaint in *SEC v. Digitran Systems, Incorporated*<sup>16</sup> alleged that Digitran improperly recognized revenue on several transactions. Digitran's false claims of having sold simulators to customers resulted in income statements in which total revenue was inflated by 46 percent to 93 percent. Improperly recognized revenue was reflected in periodic filings, a registration statement, and press releases. In addition, two of the individual defendants sold Digitran stock while in possession of material non-public information regarding the company's financial condition and operations. This case was pending at the end of the year.

The Commission filed an action against four former members of senior management at Kurzweil Applied Intelligence, Inc., who engaged in a scheme to inflate Kurzweil's revenues and income at the time of the company's initial public offering in 1993. In *SEC v. Bradstreet*,<sup>17</sup> the Commission alleged Kurzweil recognized revenue from non-existent sales and from sales that did not meet the requirements of Generally Accepted Accounting Principles (GAAP). As a result, Kurzweil reported operating results for 1993 that overstated revenue by \$2,760,000, or 25 percent, and reported a profit of \$154,000 instead of a loss of \$2,293,000; for the nine months ended October 31, 1993, Kurzweil overstated revenue by \$5,736,000, or 76 percent, and reported net income of \$649,000 instead of a loss of \$5,518,000. These misstated results were included in Kurzweil's Form S-1 registration statement and in quarterly reports filed with the Commission. Two of the individual defendants also sold Kurzweil stock while in possession of material non-public information concerning the company's true financial condition. This case was pending at the end of the year.

The Commission issued a Report of Investigation, pursuant to Section 21(a) of the Exchange Act, *In the Matter of The Cooper Companies, Inc.*,<sup>18</sup> concerning the failure of Cooper's board of directors to respond adequately to information concerning potential misconduct by Gary Singer, Cooper's former co-chairman, and his brother, Steven Singer, who was then a Cooper director and its chief administrative officer. Among other things, Gary Singer failed to disclose a series of transactions by which he caused \$6 million in high-yield bonds to be transferred between Cooper accounts and accounts in the names of his wife and aunt; these unauthorized transactions deprived Cooper and its shareholders of profits in excess of \$560,000. After the board learned that he had concealed these fraudulent, self-dealing transactions and thereby caused the company's outstanding reports to be inaccurate, the board failed to

take immediate and effective action to protect the interests of the company's investors. The board's inaction also allowed Steven Singer, who was allegedly involved in a frontrunning scheme that was under investigation by the Commission, to direct the issuance of a press release on behalf of the company that falsely denied any knowledge of wrongdoing. The Commission's report was issued to emphasize the responsibility of directors to safeguard both the integrity of corporate statements and the interests of investors, when they become aware of evidence of fraudulent conduct by management.

The Commission found in *In the Matter of Marvin E. Basson, CPA*,<sup>19</sup> that the outside auditor of Towers Financial Corporation committed fraud and engaged in improper professional conduct in connection with his audit and audit reports on the company's financial statements for the years 1988 through 1991. The financial statements filed by Towers during this period overstated income and accounts receivable, which were not recorded in accordance with generally accepted accounting principles. Basson also was enjoined by consent in related proceedings. The respondent consented to the entry of the Commission's order pursuant to Rule 2(e) (now recodified as Rule 102(e)) of the Rules of Practice, by which he was denied the privilege of appearing or practicing before the Commission.

In *In the Matter of C. Steven Bolen*,<sup>20</sup> the Commission denied the respondent the privilege of appearing or practicing before the Commission. Bolen, the former executive vice president and chief financial officer of Financial News Network, Inc. (FNN), had been enjoined by consent in 1994, based upon his participation in a fraudulent scheme to inflate FNN's revenues and earnings for 1989 and the first three quarters of 1990, by, among other things, causing an overstatement of revenues received from two related companies

and an understatement of the write-off of the assets of a discontinued FNN business segment. FNN also had been caused to enter into numerous equipment sale/leaseback transactions in which the quantity, type, and value of the equipment being sold; the identities of the sellers; and the disposition of the proceeds from the transactions were falsified. Bolen consented to the entry of the Commission's order entered pursuant to Rule 2(e).

### *Derivative Securities*

The Commission conducted several major investigations involving transactions in the market for derivative securities. The Commission instituted cease and desist proceedings against BT Securities Corporation, a broker-dealer subsidiary of Bankers Trust New York Corporation. In *In the Matter of BT Securities Corporation*,<sup>21</sup> the Commission found that BT Securities defrauded a customer, Gibson Greetings, Inc., by misrepresenting the value of Gibson's derivatives portfolio. The actions of BT Securities caused Gibson to continue to purchase derivatives. In addition, the false information supplied by BT Securities led Gibson to understate the extent of its unrealized losses in financial statements filed with the Commission and distributed to the public. BT Securities consented to the entry of orders issued by the Commission and the Commodity Futures Trading Commission that together required the payment of a penalty of \$10 million.

In proceedings related to the action against BT Securities Corporation, the Commission, in *In the Matter of Gibson Greetings, Inc.*,<sup>22</sup> alleged that Gibson violated the reporting and books and records provisions of the federal securities laws in connection with its accounting for and disclosure of certain derivatives that it had purchased on the advice of BT Securities. Among other things, Gibson failed to establish internal controls sufficient to identify such

derivative positions and require that they be marked to market, and to ensure that derivative transactions were properly executed. The respondents in this matter consented to the entry of the Commission's cease and desist order.

In *SEC v. Schulte*,<sup>23</sup> the Commission claimed that a securities salesman fraudulently sold millions of dollars in derivative securities to at least 14 Ohio municipalities and school districts. Schulte allegedly failed to describe the nature of the risks of the securities, failed to inform investors of the type of securities being sold, and falsely represented to investors that the derivatives were guaranteed by the U.S. Government. Total losses sustained by the investors have not been determined, but the Commission alleged that losses by four of the investors alone exceeded \$3.4 million. This case was pending at the end of the year.

In *In the Matter of Van Kampen American Capital Asset Management, Inc.*,<sup>24</sup> the Commission alleged the intentional mispricing by the respondent's portfolio manager of certain derivative securities held in its portfolio. The mispricing was intended to conceal a decline in the value of the securities, and resulted in an overvaluing of the portfolio by \$6.88 million and calculation of net asset value inflated by as much as 76 cents per share. The respondent consented to the entry of the order by which it was censured and ordered to pay a civil penalty of \$50,000. In related proceedings, the Commission also took action against the portfolio manager. In *In the Matter of Thomas M. Rogge*,<sup>25</sup> the Commission alleged, among other things, the respondent caused Van Kampen's records to reflect that prices for the securities at issue had been obtained from brokerage firms, when in fact he was pricing the securities himself. Rogge consented to the entry of a cease and desist order by which he was ordered to pay a civil penalty of \$11,000; he also consented to a bar from association with any regulated entity.

In *In the Matter of Askin Capital Management, L.P.*,<sup>26</sup> the Commission alleged antifraud violations in connection with the valuation of portfolios invested in mortgage derivative securities and other collateralized mortgage obligations. Among other things, the respondents, Askin Capital Management and its chief executive officer, David Askin, disseminated misleading performance information to advisory clients and prospective clients in written reports and oral presentations. The respondents consented to the entry of cease and desist orders. Askin Capital Management's registration was revoked, and Askin was barred from association with regulated entities and ordered to pay \$50,000 to settle pending or future claims by or on behalf of one or more of the advisory clients of Askin Capital Management

### *Municipal Securities*

The Commission has become increasingly concerned with activities in the municipal securities markets. In recent years, the individual investor increasingly has become an important player in the market for municipal securities, both through direct purchases of municipal bonds and through investments in mutual funds that hold these instruments. Accordingly, the Commission's enforcement program has been focusing more attention in this area, resulting in several important enforcement actions being brought by the Commission in 1995.

The Commission filed an injunctive action, involving alleged political corruption, against Terry D. Busbee, an elected board member of the Escambia County Utilities Authority (ECUA), located in Florida, and Preston C. Bynum, an employee of a broker-dealer firm. In *SEC v. Busbee*,<sup>27</sup> the Commission's complaint claims that Busbee and Bynum entered into an arrangement by which Busbee received financial benefits from Bynum at a time when Bynum's firm

was selected as the senior underwriter or senior managing underwriter for several issues of ECUA municipal securities. In connection with the arrangement, Busbee allegedly received bank loans of \$36,000, repayment of approximately \$27,000 in principal and interest on these loans, and a direct payment of \$3,500. Busbee and Bynum consented to the entry of injunctions. In addition, Bynum agreed to pay a civil money penalty in the amount of \$25,000 and, in related administrative proceedings, *In the Matter of Preston C. Bynum*,<sup>28</sup> consented to the entry of an order by which he was barred from association with regulated entities.

In *In the Matter of Derryl W. Peden*,<sup>29</sup> the Commission settled a portion of the administrative proceeding instituted last year against Thorn, Alvis, Welch. According to the order instituting the proceeding, a municipal bond underwriter allegedly engaged in a scheme in which sham transactions were used to conceal the payment of issuance costs out of bond proceeds, in excess of amounts permitted under the Internal Revenue Code. The bonds at issue were sold to finance certain urban renewal projects. Thorn Alvis's president and its bond counsel allegedly caused Thorn Alvis falsely to represent that the developer of the projects was providing cash contributions, when, in fact, part of the bond proceeds were simply being routed through the developer—by inflating his fee—to create the appearance of cash contributions. Peden, the bond counsel, consented to the entry of a cease and desist order, and agreed to disgorge \$35,000. The remainder of the action was pending at the end of the year.

In *SEC v. Stifel, Nicolaus and Company, Inc.*,<sup>30</sup> the Commission alleged that, between 1989 and 1993, a broker-dealer accepted millions of dollars in undisclosed payments from certain third parties who sold investments to municipal bond issuers advised by the broker-dealer. In advising the issuers about the purchase of these

investments, Stifel defrauded its clients by failing to disclose its conflict of interest. Stifel consented to the entry of an injunction and agreed to disgorge \$922,741, pay prejudgment interest on that amount of \$263,637, and pay a civil money penalty of \$250,000. In pending proceedings, *SEC v. Cochran*<sup>31</sup> the Commission alleged that three former employees of Stifel failed to comply with their duty to disclose the same conflicts of interest to the firm's clients.

The Commission alleged in *SEC v. Sutcliffe*,<sup>32</sup> that the defendant defrauded investors by participating in the preparation of false and misleading municipal bond offering circulars. Sutcliffe was the undisclosed promoter and control person of two not-for-profit corporations that participated in 26 public offerings of municipal and corporate bonds that raised over \$107 million to acquire, renovate, and operate nursing homes. Among other things alleged by the Commission, the offering circular for one of the offerings contained material misrepresentations and omissions concerning the defendant's role as a promoter of the offering, his control over the issuer, his regulatory history, and the commingling of revenues from existing nursing homes. Sutcliffe consented to the entry of an injunction. In a related action, *SEC v. Goodman*,<sup>33</sup> the underwriter's representative and the underwriter's counsel consented to the entry of injunctions.

In *SEC v. Rudi*,<sup>34</sup> the Commission alleged the payment of more than \$300,000 in kickbacks to a financial adviser in connection with the offering of debt securities by New Jersey's Camden County Municipal Utilities Authority. When the financial adviser, Consolidated Financial Management, Inc., was informed that it would receive a flat fee of \$15,000 instead of its fee in prior offerings of \$1 per \$1,000 face value of the bonds offered, Nicholas Rudi, the adviser's president, solicited and ultimately received a kickback of \$200,000 from First Fidelity Bank, N.A., the underwriter of the offer. Joseph

Salema, at the time the executive vice-president of Consolidated Financial Management, also solicited and received a \$90,000 kickback from Robert Jablonski, a commissioner of the New Jersey Highway Authority, in exchange for assistance in securing the selection of First Fidelity as lead underwriter. Salema and two individuals associated with First Fidelity consented to the entry of injunctions and agreed to pay a total of \$347,000, representing disgorgement and prejudgment interest. This action was pending as to Rudi, and a financial advisory firm he owns, at the end of the year.

### *Insider Trading*

Insider trading occurs when a person in possession of material non-public information engages in securities transactions or communicates such information to others who trade. Insider trading encompasses more than trading and tipping by traditional insiders, such as officers or directors who are subject to a duty to either disclose any material non-public information or abstain from trading in the securities of their own company. Violations also may arise from the transmission or use of material non-public information by persons in a variety of other positions of trust and confidence or by those who misappropriate such information.

In addition to permanent injunctions, the Commission often seeks ancillary relief, including disgorgement of any profits gained or losses avoided. The ITSA penalty provisions authorize the Commission to seek a civil penalty, payable to the United States Treasury, of up to three times the profit gained or loss avoided against persons who unlawfully trade in securities while in possession of material non-public information or who unlawfully communicate material non-public information to others who trade. Civil penalties also can be imposed upon persons who control insider

traders. During 1995, the Commission brought 45 cases alleging insider trading violations.

The Commission filed an action against 17 individuals alleging insider trading in connection with 4 AT&T acquisition targets: Paradyne Corporation, NCR Corporation, Digital Microwave Corporation, and Teradata Corporation (*SEC v. Brumfield*<sup>35</sup>). Charles Brumfield, at the time a vice president in AT&T's Human Resources Department, used his position at AT&T to learn of the company's acquisition plans. With the assistance of Thomas Alger, his close friend and subordinate at AT&T, Brumfield orchestrated widespread trading in the securities of the four takeover targets through a circle of family and friends in New York, New Jersey, Illinois, Florida, and North Carolina. The combined trading profits of the defendants was approximately \$2.6 million. In related proceedings, seven of the defendants in the Commission's action also pled guilty to criminal charges, and an eighth defendant was convicted after a jury trial.

The Commission filed an action against seven defendants alleging that they committed insider trading by purchasing the securities of Grumman Corporation or by tipping others so that they could purchase Grumman securities, shortly before the announcement of a tender offer by Martin Marietta Corporation for Grumman's outstanding shares (*SEC v. Croce*<sup>36</sup>). Nicholas Croce, a Grumman employee directly involved in due diligence meetings in preparation for the merger, tipped his brother, Frank Croce, also a Grumman employee, who then tipped their cousin, Frank Sanitate, who purchased Grumman securities himself and tipped the other defendants. Frank Sanitate, his five tippees, and six other people to whom these tippees recommended Grumman securities, realized gains totaling more than \$640,000. The defendants consented to the entry of injunctions. In addition, they agreed to pay a total of

\$295,214 representing disgorgement, prejudgment interest, and civil penalties. In related proceedings, Lawrence M. Mathe also consented to an injunction based on his trading in and recommendation of Grumman securities, and agreed to pay \$265,313, representing disgorgement, prejudgment interest, and a civil penalty.

The Commission alleged that Stephen H. Wagner, an attorney in the Legal Department of Lockheed Corporation, engaged in insider trading when he purchased call options for Lockheed stock while in possession of material non-public information concerning a merger agreement between Lockheed and Martin Marietta Corporation (*SEC v. Wagner*<sup>37</sup>). Wagner, who learned of the merger by virtue of his employment in the Legal Department, bought options that had an expiration date of only 18 days after the date of purchase and that were "out of the money" (*i.e.*, had an exercise price that was substantially in excess of the current trading price of Lockheed common stock). Wagner consented to the entry of an injunction and an order requiring him to disgorge \$42,188, plus prejudgment interest of \$2,213.87, and to pay an ITSA penalty of \$42,188.

The Commission charged two former executives of the Los Angeles based footwear company, L.A. Gear, Inc., with insider trading (*SEC v. Schwartzberg*<sup>38</sup>). The defendants, Gilbert N. Schwartzberg, the former chief administrative officer and a director of the company, and Arden Franklin, the former controller of the company, also were charged with falsifying LA Gear's books and records. In addition, Schwartzberg was charged with causing LA Gear to file a false and misleading financial report with the Commission. Schwartzberg and Franklin consented to the entry of injunctions, and agreed to pay \$1 million and \$20,185,65, respectively, representing disgorgement, prejudgment interest, and

civil penalties. In addition, Schwartzberg agreed not to serve as an officer or director of any public company.

In *SEC v. Seibald*,<sup>39</sup> the Commission alleged that on four separate occasions between July 1990 and January 1991, Jack D. Seibald, while employed as an equity research analyst at Salomon Brothers Inc., obtained material non-public information relating to several public companies he followed and unlawfully conveyed such information to defendants Bernard Seibald (his brother and a former stockbroker at Prudential Bache Securities), Stewart R. Spector (his father-in-law and a former managing director of Furman, Selz Inc.), Eric S. Fessler (his friend), and other persons. The complaint further alleges that after receiving such information from Seibald, Bernhard, Spector, and Fessler unlawfully traded in the securities of the subject companies for their own accounts and, in the case of Bernhard and Spector, for the accounts of the two incorporated entities named in the action as relief defendants, whose beneficial owners are related to Seibald and Bernhard, Fessler consented to the entry of an injunction and agreed to disgorge \$53,000 plus \$21,594 in prejudgment interest. The proceedings were pending against the other defendants at the end of the year.

*SEC v. Woodward*<sup>40</sup> involved charges that Richard W. Woodward, an attorney formerly associated with Cravath, Swaine & Moore, improperly caused his brother, John T. Woodward, and a friend to purchase the securities of 12 issuers that were Cravath clients or possible merger partners of Cravath clients in advance of possible merger and acquisition announcements. Those mergers and acquisitions included the acquisition of Caesars World by ITT, the acquisition of Neutrogena by Johnson & Johnson, and the proposed acquisition of CBS, Inc. by QVC, Inc. John Woodward purchased the securities of the subjects of such mergers and acquisitions, and caused others to purchase, resulting in total profits of approximately

\$578,000. Richard Woodward's friend, and people he caused to trade, made profits of approximately \$355,000. Richard Woodward and John Woodward consented to the entry of injunctions. In addition, Richard and John Woodward consented to disgorge \$25,000 and \$85,000, respectively.

Section 15(f) of the Exchange Act and Section 204A of the Advisers Act, which were enacted as part of ITSFEA, require broker-dealers and investment advisers to establish, maintain, and enforce written policies and procedures reasonably designed to prevent the misuse of material non-public information by such regulated entities or by persons associated with them. In *In the Matter of Gabelli & Company, Inc.*,<sup>41</sup> the Commission alleged that Gabelli & Company, a registered broker-dealer and an indirect majority-owned subsidiary of Gabelli Funds, Inc. (GFI), and GAMCO, an investment adviser and a majority-owned subsidiary of GFI, failed to adopt policies, procedures, and practices reasonably designed to prevent the misuse of material non-public information in connection with the purchase and sale of Lynch Corporation securities, by accounts maintained at the respondents, prior to a board meeting at which Lynch's board of directors approved Lynch's fourth quarter and year-end 1991 financial results, and the release of those financial results. Specifically, respondents' policies, procedures, and practices did not adequately take into account the special circumstances presented by Mario J. Gabelli's role as chairman of the board of directors and chief executive officer of Lynch and his roles as de facto chief investment officer of Gabelli & Company and chief investment officer of GAMCO. The respondents consented to the entry of a cease and desist order, and, among other things, agreed to each pay civil penalties of \$50,000.

## *Regulated Entities*

### *1. Broker-Dealers*

Each year, the Commission files a significant number of enforcement actions against broker-dealer firms and persons associated with them. The Commission's actions against broker-dealers often focus on violations of the net capital and customer protection rules, violations of books and records provisions, or fraudulent sales practices. The Commission also takes action against broker-dealer firms and their senior management for failure to supervise employees with a view to preventing violations of the federal securities laws.

In *SEC v. Stratton Oakmont, Inc.*,<sup>42</sup> the Commission alleged that a broker-dealer firm had failed to comply with a Commission order entered on March 17, 1994, in a prior enforcement action. The administrative order, to which Stratton Oakmont had consented, found that the firm had engaged in fraudulent sales practices, made baseless price predictions, permitted unauthorized trading in customer accounts, and manipulated the price of a security. Stratton Oakmont was directed, among other things, to implement sales practice procedures recommended by an independent outside consultant appointed by the Commission. The consultant recommended that Stratton overhaul its operations and sales practices and, among other things, recommended that Stratton tape record all telephone calls made to and from its customers, hire additional supervisors with acceptable disciplinary and compliance records, hire additional compliance persons, revamp the system by which Stratton compensates its brokers, take steps to ensure that all sales scripts used by Stratton brokers are completely accurate and up-to-date, and make significant changes to the manner by which Stratton responds to complaints from customers. Stratton refused to

make any of these changes. Following a non-jury trial, the court entered a permanent injunction requiring Stratton to comply with the Commission's order.

The Commission alleged a manipulation in the price of securities issued by Of Counsel Enterprises, Inc., by three broker-dealer firms, F.N. Wolf & Co., Inc., Hibbard Brown & Co., Inc., and L.C. Wegard & Co., Inc., and three individuals who were their principals (*In the Matter of F.N. Wolf & Co., Inc.*<sup>43</sup>). Respondents purchased the securities at ever-increasing prices, and Wolf & Co. entered ever-increasing bids into the NASDAQ system. The firms dominated and controlled the market for the securities and substantially reduced the float. As a result, the price was manipulated from \$3.25 to \$8; the securities were then sold to the public at the inflated price and the respondents realized profits totaling \$5,658,000. These proceedings were pending at the end of the year.

Stephen Strabala, a former registered representative associated with a broker-dealer, entered into an agreement with Columbiana County, Ohio, to invest county funds in U.S. Treasury securities and insured investments such as certificates of deposit. Strabala subsequently opened a cash and margin account in the name of "S&S Investments" at a broker-dealer firm in Orna, to which a total of \$7,735 million in county funds were wired. Strabala used the county's funds to invest in index options, while providing the county with false confirmations of transactions in Treasury notes and certificates of deposit. A net trading loss of \$3.5 million was incurred on the trades. Among other things, Strabala also diverted \$334,000 from this account to pay for a condominium and for other personal purposes. In two other accounts opened in Detroit and Palo Alto with county funds, losses of \$400,000 and \$1.82 million, respectively, were generated. Strabala consented to the entry of an order by which he was barred from association with any regulated entity (*In the*

*Matter of Stephen T. Strabala*<sup>44</sup>). Strabala also was enjoined in related civil proceedings, and ordered to disgorge \$334,000, plus prejudgment interest (*SEC v. Strabala*<sup>45</sup>).

*In the Matter of H.D. Vest Investment Securities, Inc.*<sup>46</sup> arose from activities by a registered representative associated with H.D. Vest, who created an investment club, primarily for trading index options, and converted funds invested in the club to his own use. The registered representative also used forged authorizations to transfer funds from other customer accounts to a bank account under his control, which funds he also converted. The Commission alleged that H.D. Vest failed reasonably to supervise the registered representative; among other things, the firm failed to place the employee under heightened scrutiny when it became aware of his questionable employment background (including an arbitration filed by a customer related to his association with another broker-dealer) and his request to have discretionary authority for the investment club even though he knew or should have known that the arrangement violated the firm's policy on discretionary trading. H.D. Vest consented to the entry of an order by which it was censured, ordered to pay a civil penalty of \$50,000, and required to comply with undertakings concerning supervision and other matters.

## *2. Investment Advisers and Investment Companies*

The Commission instituted several significant cases involving investment advisers and investment companies. The Commission alleged that Sanjay Saxena, a registered investment adviser and the publisher of a weekly investment newsletter, raised at least \$3.2 million through the sale to at least 165 investors of interests in an unregistered investment pool (*SEC v. Saxena*<sup>47</sup>). Saxena promised annual returns in excess of 50 percent, and further promised that he would repay one-quarter of any trading losses. While the pool was

incurring substantial losses, Saxena represented to his investors that their investments were profitable. After the Commission commenced its investigation, Saxena represented that he would repay investors in full; however, he failed to repay at least \$656,000 to at least 45 investors, who were sent false monthly statements indicating that their investments were profitable while their funds were in fact being used to repay other investors. Saxena consented to the entry of an injunction and an order requiring him to pay a total of \$774,793.04, representing disgorgement and prejudgment and postjudgment interest. In related administrative proceedings, Saxena consented to the entry of an order barring him from association with any regulated entity.

Account Management Corporation (AMC), a registered investment adviser, and two individuals, AMC's president and vice-president, were charged with inadequately disclosing the firm's allocation policy with respect to certain profitable transactions in "hot issues" (*In the Matter of Account Management Corporation*<sup>48</sup>). During an 18-month period in 1992 and 1993, AMC bought and sold securities in 34 initial public offerings that generated short-term trading profits of approximately \$337,000. Instead of distributing the shares equitably to all of its eligible accounts, the respondents principally favored certain accounts maintained for non-fee paying customers who were close friends of the respondents. In addition, trades by such accounts frequently involved free-riding; that is, purchases were made when there were inadequate funds in the accounts, so that the purchases were financed by the proceeds of the subsequent profitable re-sales. In one instance, an account was not opened until three days after a profit was realized on a re-sale. The respondents consented to the entry of a cease and desist order by which they were censured and AMC was ordered to pay a civil penalty of \$100,000.

Between 1990 and 1992, Roger W. Honour allegedly traded personally in securities that he also was buying or selling for his investment advisory clients, including individuals and investment companies. Honour's trading, which involved a conflict of interest because of the proximity of his trading to that of his clients and the low trading volume of the securities in comparison to the size of the trades made for his clients, resulted in total illegal profits of \$115,615. Honour consented to a cease and desist order by which he was censured and ordered to disgorge \$115,615, plus prejudgment interest, and to pay a civil penalty of \$275,000 (*In the Matter of Roger W. Honour*<sup>49</sup>).

The complaint against John J. Kaweske, a former portfolio manager with Invesco, a registered investment adviser and complex of mutual funds, alleged a fraudulent scheme by which Kaweske concealed from Invesco management certain secret arrangements by which his son directly and indirectly received commissions from issuers of securities, based upon purchases of those securities by funds advised by Invesco and managed by Kaweske; Kaweske allegedly caused two funds to invest in private placements of two development stage companies, for which his son received finder's fees (*SEC v. Kaweske*<sup>50</sup>). Kaweske also concealed from Invesco and funds he managed that he was a founder, director, and shareholder in a corporation whose shares or subsidiary's shares were purchased by the funds. In addition, Kaweske failed to report at least 47 personal securities transactions to Invesco management; many of these transactions involved securities that were bought or sold by Invesco funds that Kaweske managed. This case was pending at the end of the year.

In *In the Matter of John Logan Wallace*,<sup>51</sup> the Commission alleged that the respondent, a portfolio manager associated with Oppenheimer Management Corporation, bought shares in a private

placement offering through a personal account at a registered broker-dealer without properly reporting this transaction to his employer, as required by Section 17(j) of the Investment Company Act of 1940 and Rule 17j-1(c), within 10 days of the end of the calendar quarter in which the transaction occurred. Wallace consented to the entry of a cease and desist order by which he was censured and required to pay a civil penalty of \$20,000.

The Commission alleged that Louis Acevedo, a registered investment adviser, and an entity under his control, Galleon Capital Management, engaged in a scheme to misappropriate "soft dollar" funds intended for the benefit of their investment advisory clients (*SEC v. Galleon Capital Management*<sup>52</sup>). "Soft dollar" agreements between an investment adviser and a broker-dealer typically stipulate that a percentage of commissions generated in client accounts may be paid to providers of research services for research that benefits the clients. The defendants created phony invoices for services provided pursuant to a soft dollar arrangement, and submitted these invoices to brokers. Payments received were transferred to Acevedo and did not benefit investment advisory clients. Also, brokers were double billed for certain soft dollar services, or were billed for services that were not appropriate for soft dollar reimbursement. In addition, the defendants churned one or more accounts to generate soft dollar credits. The defendants consented to the entry of an injunction and an order requiring the disgorgement of \$285,916, representing illegal profits obtained as a result of the scheme.

The Commission instituted cease and desist proceedings against Anthony J. Benincasa, who aided and abetted a Ponzi scheme by which Peter T. Jones, an unregistered investment adviser, raised at least \$9.2 million from over 400 investors (*In the Matter of Anthony J. Benincasa*<sup>53</sup>). Benincasa opened accounts which falsely identified a company under his control, Independence

Asset Management (IAM), as a partnership involving Jones and a third party. Among other things, Benincasa continued to use funds placed by investors in IAM even though he knew that Jones was making material misrepresentations and omissions to investors. He also told investors that the fund was doing well when it was actually losing money. During the relevant period, IAM generated net commissions of \$333,000 for Benincasa. These proceedings were pending at the end of the year. In separate proceedings, Jones and IAM were enjoined and Jones was barred from association with any regulated entity.

See also *In the Matter of Van Kampen American Capital Asset Management, Inc.*, and *In the Matter of Askin Capital Management, L.P.*, described above.

### **Investor Education and Assistance Activities**

Investor complaints and inquiries alert the Commission to securities fraud and abuse and are often the first indicators of wrongdoing. Since an educated investor provides the best defense against securities fraud, in 1995 the SEC continued its initiative to improve public awareness and to educate investors on how to identify securities fraud, and how to report suspicious activity to securities regulators.

In October 1994, the SEC created a toll-free investor information line. The investor information line allows callers to order investor education materials and learn how the Commission can assist them with their complaints. It also provides access to important recorded investor protection messages. Since its inception in October 1994, over 75,000 calls have been received on the investor information line (1-800-SEC-0330).

During 1995, the Commission released its second brochure, *Invest Wisely, An Introduction to Mutual Funds* which provides basic information to help investors select mutual funds, identify decisions to be made before making an initial investment choice, and resolve particular problems that may arise. Over 277,000 copies of the *Invest Wisely* brochures have been distributed since March 1994 when the first brochure was released. In July 1995, the Commission released *What Every Investor Should Know about Settling Trades in Three Days, Introducing T+3*, which provides basic information on when investors must settle their securities transactions. Over 8,000 of the *Introducing T+3* brochures were distributed during 1995.

Emphasis on increased participation of individual investors in Commission rulemaking activities continued in 1995. Several Commission rule proposals published in plain English, including how risk ought to be disclosed in mutual funds, how to improve prices when buying or selling stocks, and executive and director compensation disclosure, resulted in over 5,000 comments being received from individual investors.

Investor town meetings also continued in 1995 with over 3,000 investors attending meetings held in Albuquerque, Dallas, Houston, and Nashville.

### **Sources for Further Inquiry**

The agency publishes the *SEC Docket*, which includes announcements regarding enforcement actions. SEC 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, and the disposition or status of the case, as well as other information. The *SEC Docket* also contains Commission orders instituting administrative proceedings, making

findings, and imposing sanctions in those proceedings, and initial decisions and significant procedural rulings issued by Administrative Law Judges. In addition, recent litigation releases, orders in administrative proceedings, and other information of interest to investors are posted on the Internet at the SEC's World Wide Web site (<http://www.sec.gov>).

## **International Affairs**

*The Office of International Affairs (OLA) has primary responsibility for the negotiation and implementation of information-sharing arrangements and the development of 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 under various international conventions, freezing assets located abroad, and enforcing judgments obtained by the SEC against foreign parties. In addition, OIA operates in a consultative role regarding the significant ongoing international programs and initiatives of the SEC's other divisions and offices. OIA is responsible for the SEC's technical assistance programs for countries with emerging securities markets. OIA also consults with and provides technical assistance to other Federal agencies regarding trade-related issues relevant to the regulation of securities markets in the United States.*

### **Key 1995 Results**

OIA made 230 requests for enforcement assistance on behalf of the Commission to foreign governments and responded to 337 requests for enforcement assistance from foreign governments.

The SEC signed understandings to assist in law enforcement and regulatory matters with South African authorities, including the Financial Services Board (FSB), the Securities Regulation Panel (SRP) and the Office for Banks (OFB). In addition, the SEC signed declarations of intent with the two South African securities regulators, the FSB and the SRP, to enter into comprehensive information-

sharing Memoranda of Understanding (MOU) once the South African bodies obtain the necessary authority to do so. Also, the SEC signed a declaration on cooperation with the United Kingdom Investment Management Regulatory Organization (IMRO) to facilitate information-sharing and joint inspections of registered investment advisers.

The SEC's leadership role and active involvement in the Council of Securities Regulators of the Americas (COSRA) and the International Organization of Securities Commissions (IOSCO) have advanced Commission goals for international regulatory and market oversight issues on a multilateral basis. During the past year, the membership of COSRA adopted principles of effective market oversight which describe the mechanisms needed for establishing and implementing a self-regulatory system for effective market oversight, with an emphasis on the critical role of government oversight to ensure a balance between industry self-interest and the public interest. For example, substantial progress has been made on developing internationally acceptable accounting standards for cross-border offerings, as evidenced by the agreement of the IOSCO Technical Committee and the International Accounting Standards Committee (IASC) to a work plan that, when successfully completed, will result in a comprehensive core set of international accounting standards (IAS). In addition, the IOSCO Technical Committee jointly issued a paper with the Basle Committee on Banking Supervision setting forth a framework for regulators to assess information on the derivatives activities of securities firms and banks.

### **Arrangements for Mutual Assistance and Exchanges of Information**

The SEC has an increasing need to obtain foreign-based information to protect the United States markets and investors from

cross-border fraud and other violations of the United States securities laws. In this regard, the SEC has developed ways to enhance international mechanisms for effective market surveillance and information-sharing, and for cooperation in the investigation and prosecution of cross-border fraud and market manipulation.

The SEC has worked actively to forge strong bilateral and multilateral relationships with its foreign counterparts. In particular, the SEC has entered into approximately 25 MOUs and other less comprehensive agreements, to establish the means for sharing information and providing comprehensive enforcement assistance in virtually all facets of the securities markets. Such mechanisms have improved the SEC's ability to detect and prosecute violations of the United States securities laws where information is needed from abroad. The SEC is using the relationships established through MOUs to expand cooperation beyond specific enforcement matters, including, for example, oversight of investment management activity with U.K. authorities. In addition, the SEC's commitment to international securities organizations has augmented its bilateral and multilateral efforts in the enforcement area.

On March 2, 1995, the SEC signed understandings with key South African authorities: the FSB, which regulates financial markets and brokerage institutions; the SRP, which oversees corporate takeovers and mergers and administers insider trading laws; and the OFB, which supervises the nation's banks. Three sets of agreements were utilized to reflect the current regulatory structure in South Africa and to make the broadest provisions of assistance possible in securities matters. The understandings signed with the FSB and the SRP include both communiqués, which embody each party's commitment to assist in securities law enforcement and regulatory matters, and declarations of intent, which signify the commitment to enter comprehensive information-sharing Memoranda of

Understanding once the South African regulators have obtained the necessary authority under South African law to implement such agreements. A declaration signed with the OFB should similarly enhance the ability of that body to share bank-related information critical to market oversight. Thus, the understandings are the first step of an evolving relationship with the South African authorities.

In addition, in May 1995, the SEC signed a declaration on cooperation with the U.K. IMRO. The declaration is the first bilateral cooperative arrangement focused on the cross-border investment advisory business. It also builds on the provisions in the SEC's MOU with the U.K. for sharing information and providing assistance relating to cross-border investment management activity, including, in particular, assistance in conducting on-site inspections of registered investment advisers.

The SEC also has been developing and implementing a framework for the functional regulation of the securities activities of financial conglomerates. In this regard, the SEC has undertaken initiatives in a number of countries. In July 1995, the SEC announced a joint initiative with the U.K. Securities and Investments Board (SIB) to conduct in-depth studies of the financial, operational, and management controls used by selected securities firms that conduct significant cross-border derivatives and securities activities. This is the first initiative that brings together the major securities regulators in a practical exercise that will lead to a better understanding of each regulator's approaches and contribute to better information exchange. It is expected that the initiative will be extended to include authorities and firms in other jurisdictions.

### **Enforcement Cooperation**

The table below summarizes the international requests for assistance made and received by the SEC.

[table deleted]

In two insider trading cases, the assistance provided under MOUs was critical to the SEC's successful prosecution of foreign nationals. The case of *SEC v. Morris*, Civil Action No. 94-8518 (CBM) (S.D.N.Y.) provides an excellent example of how the SEC relies on international assistance in its investigations. This case involved insider trading in the securities of Hilton Hotels Corporation by non-United States persons. The suspect trading all originated in the U.K. and was conducted by persons with no apparent connection to Hilton. Using the SEC's MOU with U.K. authorities, the SEC obtained telephone records that made it possible to trace the flow of the non-public information on which the trading was based. Based on the telephone records, the SEC determined within a short time period the source of the inside information and the trail that it followed. The SEC obtained a default judgment against one of the defendants and settled with two additional defendants. Litigation against a fourth defendant is continuing. The SEC has obtained an aggregate of approximately \$400,000 in disgorgement and \$275,000 in penalties.

In another insider trading case, *SEC v. Malavasi*, Civil Action No. 95-1691 (D.D.C.), the SEC relied principally on information compelled by the Italian CONSOB, pursuant to its MOU with the SEC, to successfully bring this case. The documents produced pursuant to the MOU included bank account documents identifying the beneficial owners of accounts through which suspicious trading took place. On September 6, 1995, the SEC filed and settled a civil action against Giovanni Malavasi, secretary to the Board of Directors of Luxottica Group SpA. The complaint alleged Malavasi learned of non-public information concerning Luxottica's plans for a takeover of U.S. Shoe Corporation, and traded while in possession of this

information. Malavasi agreed to disgorge \$100,000 and pay a civil penalty of \$42,749. The investigation is continuing.

### **Technical Assistance**

The SEC provides technical assistance to emerging securities markets to assist them in developing the regulatory infrastructure necessary to promote investor confidence. The SEC's program is comprised primarily of courses offered at the SEC's headquarters, where a broad range of topics are addressed to a wide audience in a cost-effective manner. OIA is responsible for coordinating the SEC's overall international technical assistance program.

Each spring the SEC hosts the International Institute for Securities Market Development (the Market Development Institute), an intensive two-week, management-level training program covering a full range of topics relevant to the development and oversight of securities markets. The Market Development Institute is intended to promote market development, capital formation, and the building of sound regulatory structures in emerging market countries. The fifth annual Market Development Institute was held in the spring of 1995, with 96 delegates from 53 countries in attendance.

The SEC has expanded upon the successful Market Development Institute concept with a one-week International Institute for Securities Enforcement and Market Oversight (Enforcement Institute) for foreign securities regulators. This program promotes market integrity and the development of closer enforcement cooperation, and includes practical training sessions on SEC enforcement investigations, investment company and adviser inspections, broker-dealer examinations, and market surveillance. Ninety-eight individuals representing fifty-one countries attended the second annual Enforcement Institute held during the last week of October 1995.

## **International Organizations and Multilateral Initiatives**

The SEC benefits from the opportunity to better understand foreign regulations, markets, and practices through participation in multilateral organizations. Moreover, through its involvement in international organizations, the SEC has the opportunity to promote its views on important issues that affect the United States securities markets and the SEC's regulatory program, and help develop international consensus on these issues. During 1995, the SEC contributed to the work of the following international organizations and multilateral initiatives:

### *The International Organization of Securities Commissions*

IOSCO is an international forum created to promote cooperation and consultation among regulators overseeing the world's securities markets. With over 100 members, most of the world's securities regulators are represented. The SEC plays a leadership role in IOSCO. Over the years, the SEC has been actively involved in many aspects of the organization's work, particularly in work relating to: identifying accounting and auditing standards that would be used in multinational offerings; regulating the secondary market and market participants; fostering the international enforcement of securities laws; and promoting international cooperation in connection with cross-border investment funds.

At IOSCO's 1995 Annual Conference, the Technical Committee and the Board of the International Accounting Standards Committee (IASC) issued a joint press release announcing that they had agreed upon a work plan that when successfully completed, would result in a comprehensive core set of international accounting standards. Provided the Technical Committee is satisfied with this core set, it will then be in a position to recommend endorsement of the standards for cross-border capital raising and listing purposes. During 1995,

several other reports were prepared by working parties and released by IOSCO's Technical Committee. In addition, continued cooperation with the Basle Committee resulted in a joint report with the Technical Committee on a *Framework for Supervisory Information about the Derivative Activities of Banks and Securities Firms*. The report represents an important step in the ongoing cooperation between securities and banking regulators to ensure prudent oversight of the securities activities carried on by securities firms and by banks.

### *Council of Securities Regulators of the Americas*

COSRA provides a forum for mutual cooperation and communication to enhance the efforts of each country in the Americas and the Caribbean to develop and foster the growth of sound securities markets that are fair to all investors. Formed in 1992 by the securities regulatory authorities of North, South, and Central America, and the Caribbean, COSRA has proven to have a significant impact on the international cooperative efforts of securities regulators throughout the region. The SEC actively promoted the concept of a regional organization and at the Summit of the Americas, held in Miami in December 1994, the participating governments endorsed the work of COSRA. COSRA's membership represents both advanced and emerging markets, and the organization strives to enhance the efforts of each country to develop and foster the growth of fair and open securities markets. Through the development of principles on Transaction Transparency, Audit Trails, Clearance and Settlement, Cross-border Surveillance of Investment Advisers, Fundamental Elements of a Sound Disclosure System, and Enforcement Cooperation, COSRA has contributed to the development of high regulatory standards in the Americas.

At its annual meeting in 1995, COSRA adopted principles of effective market oversight which describe the mechanisms needed

for establishing and implementing a self-regulatory system for effective market oversight, with an emphasis on the critical role of government oversight to ensure a balance between industry self-interest and the public interest. COSRA also agreed on a future work agenda to cover implementation of the Summit of the Americas' anti-corruption initiatives, an examination of market structure issues, and enhancement of the capital formation process. Finally, the Inter-American Development Bank announced its decision to support and fund COSRA members' efforts to implement COSRA principles and to host the 1996 annual meeting in Washington, D.C.

## **Trade Negotiations**

As a result of the globalization of securities markets, the SEC is now regularly engaged in discussions with fellow regulators on ways to facilitate cross-border activities, including offerings, securities trading, and the provision of advisory services. In addition, the SEC increasingly has provided technical assistance to the Administration in its negotiations involving trade and market access issues.

In January 1995, the U.S.-Japan Framework Agreement on Financial Services was finalized. Among the most significant developments under the Agreement is the opening of the Japanese public pension fund market to U.S. fund managers. The Agreement also liberalized access by investment companies to the Japanese markets and, in addition, eased restrictions on introduction of new securities products in Japan.

### *United States and Asian Markets*

The SEC has been working on a bilateral basis with many countries in the Asia-Pacific region and has in place Memoranda of Understanding or other formal arrangements with the regulatory authorities of several such countries, including China, Japan, and

Indonesia. In April 1995, Chairman Arthur Levitt and New York Stock Exchange President Richard Grasso met with government officials and business executives in Southeast Asia with the goal of developing a strong relationship between Southeast Asian and U.S. securities markets. The visit included Thailand, Indonesia, Malaysia, and Singapore. The SEC has provided technical assistance to China, Thailand, and other countries in the Asia-Pacific region. The goals of such assistance are to promote and maintain the stability, efficiency, and integrity of these emerging securities markets and to encourage the adoption of U.S.-style market structures that are more likely to be open to U.S. market participants and service providers. The SEC is working to activate direct cooperation and discussion between the SEC and the Securities and Exchange Board of India as part of the U.S. Department of the Treasury's (Treasury) initiative to renew the activities of the Indo-U.S. Economic/Commercial Subcommittee. The SEC also is working with the Treasury to foster multilateral cooperation among the financial and regulatory authorities in the Asia-Pacific region.

## **Regulation of the Securities Markets**

*The Division of Market Regulation (Division) oversees the operations of the nation's securities markets and market professionals. In calendar year , the Commission supervised over 8,500 broker-dealers with 58,119 branch offices and over 505,600 registered representatives, 8 active registered securities exchanges, the NASD and the over-the-counter markets, 15 registered clearing agencies, the Municipal Securities Rulemaking Board, and the Securities Investor Protection Corporation. Broker-dealers filing FOCUS reports with the Commission had approximately \$1.5 trillion in assets and \$89 billion in capital in 1995. The Division also monitors market activity, which has experienced significant growth. At the end of calendar 1995, equity market capitalization stood at \$8 trillion in the United States and \$16.5 trillion worldwide. Average daily trading volume reached 346.6 million shares on the New York Stock Exchange and 404.6 million shares on the Nasdaq Stock Market. The fastest growing area has been derivatives activities, where the approximate notional amount of contracts outstanding at the 6 most active derivatives dealers and their affiliates is \$5.6 trillion, with an aggregate current net exposure of approximately \$39.9 billion.*

### **Key 1995 Results**

The Division proceeded with its efforts to enhance the overall efficiency of the marketplace through its ongoing review of trading systems and practices. In 1995, the SEC launched an initiative to form the Derivatives Policy Group (DPG) to address a broad range of issues pertaining to the derivatives markets. The clearance and settlement system underwent a major change as the time for settlement of transactions was shortened from five to three business days. Issuers were provided greater flexibility in offering dividend reinvestment and stock purchase plans that allow investors to obtain

shares directly from the issuer. The municipal securities program made great strides in the area of disclosure and trading systems (market transparency). The Commission approved and the industry implemented a program to enhance training of registered representatives by their broker-dealers and to establish requirements for ongoing industry-wide computer-based training.

## **Securities Markets, Trading, and Significant Regulatory Issues**

### *Derivatives*

The Division continued to be actively involved in numerous derivatives related projects. During the year, the SEC initiated the creation of the DPG, consisting of the unregistered affiliates of the six securities firms most active in the over-the-counter (OTC) derivatives markets. In March 1995, the DPG submitted a report to the SEC establishing a framework for voluntary oversight of their OTC derivatives activities. The DPG's framework included recommendations regarding management controls, enhanced reporting, evaluating risk in relation to capital, and counterparty relationships. In addition, through the SEC's risk assessment program, the Division reviewed data concerning the derivatives activities of the material affiliates of approximately 250 securities firms.

In 1995, the Commission approved proposals by five exchanges and the National Association of Securities Dealers, Inc. (NASD) to list and trade warrants based on broad-based indexes,<sup>54</sup> thereby facilitating the trading of new financial products. Moreover, the Commission amended Rule 3a12-8 under the Securities Exchange Act of 1934 (Exchange Act) to designate the sovereign debt of Spain as exempted securities for the purpose of futures trading,<sup>55</sup> and proposed a further amendment to Rule 3a12-8 to permit futures on Mexican sovereign debt.<sup>56</sup> Both of these initiatives reflect the

Commission's flexibility in adapting to the increased internationalization of the derivatives markets. Finally, the Division prepared a memorandum in response to the October 6, 1994 letter of Representative James Leach concerning the impact of derivatives activities on the global financial system. The memorandum discussed a variety of actions the Commission has taken to address the risks of derivatives products.

The Division was actively involved in the Commission's enforcement action against BT Securities Corporation (BT), arising from the sale of certain OTC derivative securities to Gibson Greetings, Inc.<sup>57</sup> Concurrent with the settlement of the Commission's action against BT, the Commission issued an order providing a temporary exemption for persons acting as brokers or dealers with respect to certain categories of OTC derivative instruments, to the extent such instruments are securities, from the broker-dealer registration requirement under Section 15(a) of the Exchange Act.<sup>58</sup> By order, the Commission extended the temporary exemption until September 30, 1996.<sup>59</sup> The extension of the exemption is intended to avoid any dislocation of existing OTC derivatives markets and to allow those broker-dealers who have not already done so time to move existing business covered by the exemption into entities that do not rely on the exemption.

The SEC took a leading role in several international efforts to improve regulatory oversight of the securities industry. In August 1995, the SEC announced a joint initiative with the United Kingdom Securities and Investments Board (SIB) to conduct in-depth studies of the financial, operational, and management controls used by selected securities firms that conduct significant cross-border derivatives and securities activities. This joint initiative builds on the joint statement previously issued by the SEC, the Commodity Futures Trading Commission, and the SIB that identified several areas in

which regulators can cooperate in their oversight of the OTC derivatives market. The Division participated in several of these in-depth joint reviews on domestic as well as foreign securities firms.

Through the SEC's membership in the Technical Committee of the International Organization of Securities Commissions (IOSCO), the Division took part in preparing an IOSCO report entitled, *The Implications for Securities Regulators of the Increased Use of Value at Risk Models by Securities Firms*. That report raised several important issues regarding the use of models for regulatory purposes and concluded that further information and analysis is required before IOSCO can consider the use of internal models for the purpose of setting capital standards for market risk. The Division also participated in the preparation of a paper, issued jointly by IOSCO and the Basle Committee on Banking Supervision, establishing a framework for supervisors to assess information on the derivatives activities of securities firms and banks. This effort built on previous joint efforts by IOSCO and the Basle Committee in the area of management control mechanisms for derivatives activities.

### *Clearance and Settlement*

The SEC continued to work to enhance all components of the national clearance and settlement system. In particular, the SEC worked closely with the SROs, broker-dealers, and industry groups on implementation of a three business day settlement period (T+3) for broker-dealer trades pursuant to Rule 15c6-1 under the Exchange Act. Prior to the implementation of the three-day settlement period, the SEC responded to concerns raised by the industry and exempted from the rule sales of certain insurance products and certain foreign securities. The SEC also amended the rule to permit new issues of securities to settle on an extended time frame under certain conditions.

The SEC worked closely with registered clearing agencies, broker-dealers, and federal bank regulators such as the Board of Governors of the Federal Reserve System (FRB), the Federal Reserve Bank of Philadelphia, and the Federal Reserve Bank of New York to achieve a safe and efficient conversion to same-day funds settlement, scheduled for implementation in 1996. In February 1996, the payment systems for securities transactions (*i.e.*, corporate and municipal securities) and principal and interest payments converted from next-day funds settlement to same-day funds settlement. The conversion affects payments for settlements among clearing corporations, depositories, and financial intermediaries and between financial intermediaries and their institutional clients. The conversion does not affect payments to and from retail investors. The same-day funds settlement system conversion should help reduce systemic risk by eliminating overnight credit risk.

### *Proposals to Improve Order Handling and Execution of Customer Orders*

On September 29, 1995, the Commission proposed for comment two rules and two amendments to an existing rule intended to improve the handling and execution of customer orders in exchange-traded securities and securities traded over the counter. The proposed rules are intended to strengthen transparency, enhance order handling, and promote interaction of customer orders. The proposal recognizes the importance of fair competition among markets and market participants and permits the securities industry to select the means to achieve the ends.<sup>60</sup>

### *Automation Initiatives*

Pursuant to Rule 17a-23 under the Exchange Act,<sup>61</sup> the Division received 96 filings for automated trading systems. The rule requires brokers and dealers that operate automated trading systems to

maintain participant, volume, and transaction records, and to report system activity periodically to the Commission.

The staff continued to perform Automation Review Policy (ARP) reviews of the exchanges, Nasdaq, and clearing agencies.<sup>62</sup> The primary purpose of the ARP program is to monitor and assess the electronic data processing facilities supporting the transaction and information dissemination activities of the SROs in their relationship to the national market system. The staff completed 10 on-site reviews and issued 7 reports, which included 46 recommendations for improvements. Typical recommendations included the need for back-up facilities for data centers, enhancements to data security efforts, and better use of capacity planning tools.

The staff received 10 technology briefings from the SROs to ascertain recent and planned changes and improvements in their automated systems. The staff also assessed the ability of SROs to respond to systems malfunctions and examined SRO measures to prevent system outages.

### *Trading Practices Developments*

*Specialists.* The Commission granted an exemption from Rules 10b-6 and 10b-13 under the Exchange Act to allow New York Stock Exchange (NYSE) specialists to continue to act in their specialist capacity during a distribution of, or a tender offer for, specialty securities when they otherwise would be subject to those rules because of their affiliates' participation in such transaction.<sup>63</sup> The exemption requires specialists and their affiliates to establish procedures to segregate the flow of confidential, market-sensitive information between a specialist and its affiliates, and notes the implementation of certain surveillance and notification procedures by the NYSE.

*Dividend Reinvestment and Stock Purchase Plans.* The Commission granted a class exemption from Rule 10b-6 under the Exchange Act for certain dividend reinvestment and stock purchase plans (DRSPPs).<sup>64</sup> The exemption facilitates access to plans by permitting investors to obtain their first shares of an issuer's securities directly from the issuer, and expands the availability of these programs to persons other than the issuer's employees and shareholders. The staff also clarified that an issuer operating a DRSPP may be acting as a broker-dealer if it induces or attempts to induce the purchase or sale of its securities; receives compensation based on securities transactions; or holds and maintains the funds, securities, and accounts of DRSPP participants. Thus, an issuer operating a DRSPP in this manner either must limit its activities through the use of an agent that is a broker-dealer or bank, or register as a broker-dealer.

The Commission, acting by delegated authority, granted exemptions pursuant to Rule 10b-10(e) under the Exchange Act to permit broker-dealers to confirm automatic dividend reinvestment transactions through the use of monthly account statements, rather than with immediate confirmations.<sup>65</sup>

*Universal Banks.* The Commission issued a letter granting exemptions from Rules 10b-6, 10b-7, and 10b-8 under the Exchange Act and addressing the effect of these rules on a universal bank (*i.e.*, a non-U.S. entity that engages in both commercial and investment banking activities).<sup>66</sup> These exemptions rely on the establishment, maintenance, enforcement, and audit of information barriers to insulate the activities of affiliated entities to permit activities that otherwise would be prohibited during the course of a distribution.

*Inter nationalization.* The Commission took a variety of actions pertaining to multinational offerings. For example, consistent with its

Statement of Policy regarding class exemptions for certain foreign issuers that conduct distributions in the United States,<sup>67</sup> the Commission granted class exemptions from Rules 10b-6, 10b-7, and 10b-8 under the Exchange Act for distributions of securities by certain highly capitalized United Kingdom issuers<sup>68</sup> and for distributions of certain highly capitalized Dutch issuers.<sup>69</sup> The exemptions permit distribution participants to effect transactions in the United Kingdom or in The Netherlands in the security being distributed and related securities, subject to certain disclosure, recordkeeping, record production, and notice requirements.

### *Municipal Securities*

*Price Transparency Initiatives.* In January 1995, the Municipal Securities Rulemaking Board (MSRB) began Phase I of its price transparency program, during which the MSRB produces a daily report of inter-dealer transactions in the more actively traded municipal securities. In future phases of the program, the MSRB will collect and publicly disseminate transaction data for all municipal securities trades. The Public Securities Association (PSA) is developing ways to reach the public with price data from the MSRB's daily report and other sources. The PSA, with two information vendors, initiated production of a generic yield scale of representative municipal prices for publication in various print media, and established a telephone service that reports contemporary and historical municipal securities transaction data to callers for a fee.

*Disclosure.* Following the publication of the Commission's March 1994 interpretive release discussing the disclosure obligations of participants in the municipal securities market under the antifraud provisions of the federal securities laws,<sup>70</sup> in November 1994 the Commission adopted amendments to Rule 15c2-12 under the Exchange Act to further deter fraud in the municipal securities

market<sup>71</sup> The amendments prohibit broker-dealers from underwriting primary offerings of municipal securities unless they have determined that continuing disclosure about the municipal securities, in the form of annual financial information and notices of certain material events, will be provided to various information repositories, including Nationally Recognized Municipal Securities Information Repositories (NRMSIRs) and state information depositories (SIDs). Material event notices also may be provided to the MSRB. The amendments also prohibit broker-dealers from recommending the purchase or sale of a municipal security in the secondary market unless they have procedures in place that assure that they will receive promptly certain material event information disclosed about that security.

The amendments, which were phased in between July 3, 1995 and January 1, 1996, allow municipal issuers and underwriters time to implement necessary procedures to facilitate compliance with the amendments.

On June 23, 1995 and September 19, 1995, the Division issued letters to the National Association of Bond Lawyers.<sup>72</sup> These letters provide extensive guidance about the amendments to Rule 15c2-12.

*Information Repositories.* In 1995, the Division announced the designation of six applicants as NRMSIRs for purposes of Rule 15c2-12.<sup>73</sup> The designated NRMSIRs are: (1) Bloomberg L.P. of Princeton, NJ; (2) Thomson Municipal Services, Inc. of New York, NY; (3) Disclosure, Inc. of Bethesda, MD; (4) Kenny Information Systems of New York, NY; (5) Moody's Investors Service of New York, NY; and (6) R.R. Donnelley of Hudson, MA.

The Commission also announced the recognition of SIDs located in Texas, Michigan, and Idaho. In adopting the amendments to Rule 15c2-12,<sup>74</sup> the Commission stated that an appropriate SID would be a depository operated or designated by the state that receives

information from all issuers within the state, and makes this information available promptly to the public on a contemporaneous basis.<sup>75</sup> A state may designate a SID through legislative or executive action.

### *Broker-Dealer Regulation*

*Extension of Credit.* An important area currently under debate in the industry and at the Commission is the role that margin should play in today's securities markets, and what steps can be taken to improve the present scheme for federal margin requirements. In 1995, the Commission worked with Congress, the industry, and other regulators to develop margin proposals that would address concerns raised about the current margin scheme while maintaining the safeguards arising from margin standards.

The staff also issued several no-action letters clarifying its position with respect to the application of the extension of credit prohibitions of Section 11(d)(1) of the Exchange Act. For example, the staff granted no-action relief from Section 11(d)(1) with respect to installment payments for an initial offering of Canadian securities sold to a limited number of Qualified Institutional Buyers in the United States pursuant to Rule 144A under the Securities Act of 1933.<sup>76</sup> The staff also issued no-action relief under Section 11(d)(1) in connection with the offer and sale by a company of certain securities issued as units generally consisting of a Treasury note and a purchase contract under which the holder would purchase stock of the company at a future date.<sup>77</sup>

*Networking Arrangements.* Having issued numerous no-action letters addressing networking arrangements among registered broker-dealers, insurance companies, and insurance agencies in connection with the offer and sale of insurance securities products, the Division issued a comprehensive, definitive letter describing in

detail the conditions under which these arrangements may be conducted without the insurance agencies or their unregistered employees registering as broker-dealers under Section 15 of the Exchange Act<sup>78</sup> In that letter, the Division expressly stated that it will no longer respond to no-action requests in this area unless the request presents novel or unusual issues.

*Confirmation Disclosure.* On November 10, 1994, the Commission adopted amendments to its confirmation rule, Rule 10b-10 under the Exchange Act, to require brokers and dealers to disclose: (1) if they are not members of the Securities Investor Protection Corporation (SIPC) (except, in limited circumstances, for transactions in mutual fund shares); (2) when a debt security is not rated by a nationally recognized statistical rating organization; (3) the availability of yield information with respect to transactions in collateralized debt securities; and (4) mark-ups and mark-downs in certain Nasdaq and regional exchange-listed securities that are subject to last sale reporting, but are not technically "reported securities" under Rule 11Aa3-1 under the Exchange Act.<sup>79</sup> The amendments also added a preliminary note clarifying that the confirmation disclosures required by Rule 10b-10 may not represent all the disclosure required under the antifraud provisions of the federal securities laws. The Commission deferred acting on a proposal to require disclosure of mark-ups in riskless principal transactions in debt securities, to allow the industry time to develop enhanced price information in the markets for those securities.

The Commission, acting by delegated authority, exempted certain limited purpose broker-dealers from the requirement to disclose that they are not members of SIPC.<sup>80</sup> The Commission, acting by delegated authority, also clarified the confirmation delivery requirements of broker-dealers regarding accounts managed by

third-party fiduciaries and the requirements with respect to disclosure of the unrated status of a debt security.<sup>81</sup>

*Supervision of Conglomerates.* The Division participated in an international effort by securities, banking, and insurance regulators to address regulation of financial conglomerates. This effort led to the issuance of a paper in April 1995 entitled, *The Supervision of Financial Conglomerates*, recognizing several effective methods of group supervision of conglomerates. The Division will pursue work on practical issues in this area through a reconstituted tripartite group.

*Application for Broker-Dealer Registration.* The Commission proposed for public comment amendments to Form BD, the uniform broker-dealer registration form under the Exchange Act.<sup>82</sup> The amendments to Form BD respond to design updates to the Central Registration Depository system operated by the NASD, which ultimately will allow for electronic filing of Form BD, as well as Forms U-4 and U-5 (the uniform form used to terminate broker-dealers and their associated persons with the Commission, the states, and the SROs). Amendments to the disclosure section of Form BD, where most of the changes are proposed to be made, would provide regulators with better information about an applicant's disciplinary history. The amendments also propose, among other things, new items to Form BD to obtain more accurate information with respect to U.S. broker-dealers that have foreign owners, broker-dealers that are affiliated with U.S. or foreign banks, and broker-dealers that conduct securities activities on the premises of financial institutions.

*Money Laundering.* The Division continued to work with the Financial Crimes Enforcement Network of the Treasury to develop practical approaches to combat money laundering. The Division participated in the Bank Secrecy Act Advisory Group and in the United States delegation to the Financial Action Task Force on

Money Laundering, and the independent group of major financial center countries and regions, which is provided technical advice with respect to potential enforcement matters.

*Arbitration.* The Commission worked closely with the principal SRO arbitration forums to address key challenges facing the arbitration systems identified by the Commission and others interested in the arbitration process. Accordingly, the Commission encouraged the work of the NYSE Symposium on Arbitration and the NASD Arbitration Policy Task Force, which were established to meet these SRO responsibilities.

The Commission approved proposed rule changes by the NASD and national securities exchanges designed to enhance the procedures for resolving disputes among broker-dealers and between broker-dealers and investors. In particular, the Commission approved amendments to arbitration rules that (1) establish a mediation program,<sup>83</sup> (2) implement a pilot program for seeking injunctive relief in infra-industry disputes,<sup>84</sup> (3) implement a voluntary pilot program administering large and complex cases,<sup>85</sup> and (4) enable the NASD to discipline members that fail to honor settlement agreements reached in the arbitration or mediation process.<sup>86</sup>

### *Unlisted Trading Privileges*

Pursuant to rulemaking requirements of the Unlisted Trading Privileges (UTP) Act of 1994, the Commission adopted new rules and amendments to existing rules under Section 12(f) of the Exchange Act on April 21, 1995.<sup>87</sup> The rules reduced the period that exchanges must wait before extending UTP to any listed initial public offering (IPO) from the third trading day in the IPO, as the UTP Act of 1994 had required temporarily, to the second trading day in the IPO. The rules also require exchanges to have rules and oversight

mechanisms in place to ensure fair and orderly markets and the protection of investors with respect to UTP in any security.

The Joint Industry Plan for UTP in OTC Securities (OTC/UTP Plan), operating under temporary Commission approval, permits exchanges to trade Nasdaq/national market securities subject to the terms of the OTC/ UTP Plan. On August 14, 1995, the Commission extended the temporary approval of the Plan, and increased the number of Nasdaq/national market securities that a participant exchange may trade from 100 to 500.<sup>88</sup>

### *Transfer Agent Regulation*

The Commission solicited comment on the concept of establishing electronic links between issuer shareholder registration systems and broker-dealer recordkeeping systems. As discussed in the concept release, one benefit of such links would be the opportunity for issuers to offer "account statements" in lieu of certificates to their shareholders and for shareholders to move their shares efficiently to their brokerage firms within the three-day settlement cycle mandated by Rule 15c6-1.<sup>89</sup>

The Commission adopted Rule 17Ad-16, which requires transfer agents to notify securities depositories when assuming or terminating services on behalf of an issuer or when changing their names or addresses.<sup>90</sup> The Commission also released for comment amendments to its transfer agent rules which are designed to address investor concerns resulting from direct registration systems and shorter trade settlement time frames (*i.e* , T+3 settlement).<sup>91</sup>

### *Lost and Stolen Securities*

Rule 17f-1 under the Exchange Act sets forth participation, reporting, and inquiry requirements for the SEC's Lost and Stolen

Securities Program.<sup>92</sup> Statistics for calendar year 1994 (the most recent data available) reflect the program's continuing effectiveness. As of December 31, 1994, 24,518 institutions were registered in the program, a 2 percent increase over 1993. The number of securities certificates reported as lost, stolen, missing, or counterfeit increased from 1,634,161 in 1993 to 2,954,692 in 1994, an 81 percent increase. The dollar value of these reported certificates decreased from \$4.0 billion in 1993 to \$3.8 billion in 1994, a 5 percent decrease. The aggregate dollar value of the securities contained in the program's database increased from \$92.6 billion in 1993 to \$96.4 billion in 1994, a 4 percent increase. The total number of certificates inquired about by participating institutions through the program decreased from 6,553,308 in 1993 to 6,245,375 in 1994, a 5 percent decrease. In 1994, the dollar value of certificate inquiries that matched previous reports of lost, missing, stolen, or counterfeit securities decreased from \$252 million in 1993 to \$159 million in 1994, a 37 percent decrease. The total number of these matches increased from 69,769 in 1993 to 269,001 in 1994, a 286 percent increase.

## **Oversight of Self-Regulatory Organizations**

### *National Securities Exchanges*

As of September 30, 1995, there were eight active securities exchanges registered with the SEC as national securities exchanges; American Stock Exchange (AMEX), Boston Stock Exchange (BSE), Chicago Board Options Exchange (CBOE), Cincinnati Stock Exchange (CSE), Chicago Stock Exchange (CHX), NYSE, Philadelphia Stock Exchange (PHLX), and Pacific Stock Exchange (PSE). The agency granted exchange applications to delist 91 debt and equity issues, and granted applications by issuers requesting withdrawal from listing and registration for 69 issues.

The exchanges submitted 364 proposed rule changes during 1995. A total of 317 pending and new filings were approved by the Commission, and 46 were withdrawn. Notable rule filings approved by the Commission included proposals;

- to adopt uniform enabling rules submitted by the AMEX, CBOE, CHX, MSRB, NASD, NYSE, PSE, and PHLX for the implementation of a continuing education program for the securities industry;<sup>93</sup>
- to extend through March 29, 1996 the existing pilot program of the CSE relating to the preferencing of public agency market and marketable limit orders by approved dealers and proprietary members;<sup>94</sup>
- to amend and extend through March 29, 1996 the existing pilot program of the BSE that permits competing specialists on the floor of the BSE;<sup>95</sup> and
- to adopt a minimum voting rights policy for shareholders of publicly traded securities submitted by the NYSE, AMEX, and NASD.<sup>96</sup>

*National Association of Securities Dealers, Inc.*

The NASD is the only national securities association registered with the SEC and includes more than 5,400 member firms. Through a wholly-owned subsidiary, the NASD owns and operates the Nasdaq Stock Market, which trades more than 5,700 securities and is the second largest stock market in the United States and the world (after the NYSE).

The NASD submitted 70 proposed rule changes to the Commission during the year. The Commission approved 66

proposed rule changes which included proposed rule changes submitted during the year and several proposed rule changes submitted in prior years. Among the significant changes approved by the Commission were:

- a prohibition against a Nasdaq market maker trading ahead of any customer limit order in a Nasdaq security sent to it for execution from another broker-dealer;<sup>97</sup>
- a restriction against certain persons receiving securities prior to the public offering when these securities trade at a premium in the secondary market (the rule does not restrict bona fide distributions of hot issues to the public);<sup>98</sup>
- requirements for filing and review of advertising and sales literature;<sup>99</sup>
- a requirement that all NASD members report customer complaints to the NASD, including quarterly summary statistics concerning customer complaints;<sup>100</sup>
- establishment of internal procedures relating to the review of requests for exemptions from Rule G-37 of the MSRB relating to restrictions on political contributions;<sup>101</sup>
- procedures governing the administration of mediation proceedings;<sup>102</sup> and
- an amendment to allow nonmembers to receive real-time access to view all orders "broadcast" through the NASD's SelectNet Service.<sup>103</sup>

## *Municipal Securities Rulemaking Board*

The MSRB is charged with the primary rulemaking authority for municipal securities dealers. The SEC received 18 new proposed rule changes from the MSRB. A total of 23 new and pending proposed rule changes were approved by the Commission. In particular, the Commission approved amendments to MSRB Rule G-15(a) to clarify the current customer confirmation requirements in municipal securities transactions.<sup>104</sup>

## *Clearing Agencies*

Fifteen clearing agencies were registered with the SEC at year-end. In addition, the SEC extended the temporary registration as a clearing agency of the Participants Trust Company,<sup>105</sup> MBS Clearing Corporation,<sup>106</sup> Delta Government Options Corporation,<sup>107</sup> and the Government Securities Clearing Corporation (GSCC).<sup>108</sup>

Registered clearing agencies submitted 157 proposed rule changes to the SEC and withdrew 9. The SEC approved 148 proposed rule changes, including the following:

- implementation of the first stage of GSCCs proposed clearance and settlement system for repurchase agreements;<sup>109</sup>
- implementation of the National Securities Clearing Corporation's (NSCC) Collateral Management Service, which allows clearing agency participants to view information regarding their clearing fund and margin deposits at NSCC and other registered clearing agencies and allows registered clearing agencies to view the same type of information about their participants at other registered clearing agencies;<sup>110</sup> and

- implementation of the Options Clearing Corporation's Stock Loan/ Hedge Program for specialist and market maker accounts, which allows stock loan and borrow transactions in these accounts to constitute hedges against stock option positions for purposes of margin calculation.<sup>111</sup>

### *Applications for Re-entry*

Rule 19h-1 under the Exchange Act prescribes the form and content of, and is the mechanism by which the Commission reviews, proposals submitted by SROs to allow persons subject to statutory disqualification, as defined in Section 3(a)(39) of the Exchange Act, to become or remain associated with member firms. In 1995, the Commission received 41 filings submitted by SROs pursuant to Rule 19h-1. Of the 41 filings, the NASD made 32, the NYSE made 8, and the CHX made 1. No applications were denied; three were withdrawn.

## **Investment Management Regulation**

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

### **Key 1995 Results**

In 1995, a large part of the work of the Division of Investment Management focused on three areas: (1) improving and simplifying communications to investment company shareholders; (2) reducing operational burdens on investment companies; and (3) modernizing the regulation of public utility holding companies. Key steps taken to improve disclosures to investment company shareholders included an initiative to simplify investment company prospectuses and to improve risk disclosure. The Commission permitted a test group of eight mutual fund groups to provide their investors with a short prospectus summary, or "profile," that would accompany the prospectus currently provided to investors. The Commission also issued a concept release seeking public comments and suggestions on how to improve the descriptions of risk provided by investment companies, including whether to require some form of quantitative risk measure in investment company prospectuses.

The Commission adopted rules under the Investment Company Act of 1940 (Investment Company Act) to allow a single mutual fund to offer multiple classes of shares with different sales charge arrangements and to permit mutual funds to impose certain types of deferred sales loads. These rules give funds greater flexibility to tailor

their sales load arrangements without having to seek exemptive relief from the Commission. The Commission also proposed amendments to the Investment Company Act rule governing the custody of fund assets outside of the United States. The proposed amendments would reduce the burdens currently placed on fund directors in reviewing foreign custody arrangements and provide funds with significantly more flexibility to select foreign custodians without sacrificing investor protection.

The Division issued a report, *The Regulation of Public Utility Holding Companies*, which describes the results of the staff's study of the regulatory framework of the Public Utility Holding Company Act of 1935 (Holding Company Act) in light of recent developments in the gas and electric utility industry. The primary recommendation of the report is that Congress should repeal the Holding Company Act and simultaneously provide necessary authority to state regulators and the Federal Energy Regulatory Commission to ensure the continued protection of consumers. The report also recommends a number of proposals for administrative reform.

## **Significant Investment Company Act Matters**

### *Rulemaking*

The Commission adopted and proposed for amendment several rules under the Investment Company Act. A description of some of these rules is provided below.

*Multiple Class Structures*, In February 1995, the Commission adopted Rule 18f-3, which permits open-end management investment companies to issue multiple classes of shares with varying arrangements for the distribution of their shares and the provision of services to their shareholders.<sup>12</sup> Rule 18f-3 eliminates many of the requirements imposed under prior Commission

exemptive orders governing multiple class structures and enables investment companies to issue multiple classes without obtaining exemptive relief from the Commission. The Commission also amended the registration form for open-end management investment companies under the Investment Company Act and the Securities Act of 1933 (Securities Act). The amendment prescribes prospectus disclosure requirements for multiple class investment companies and master-feeder arrangements, which consist of one or more "feeder" investment companies that invest in the same portfolio, or "master" investment company. A conforming amendment was made to Rule 12b-1 under the Investment Company Act, which governs the payment of asset-based sales charges.

*Deferred Sales Loads.* In February 1995, the Commission adopted Rule 6c-10, which permits open-end management investment companies to impose contingent deferred sales loads (*i.e.*, a sales load paid at redemption that declines over several years until it reaches zero) without obtaining exemptive relief from the Commission.<sup>113</sup> At the same time, the Commission proposed for comment amendments to Rule 6c-10 that would give open-end management investment companies greater flexibility to impose a wider variety of deferred sales loads, such as loads that are paid in a series of installments.<sup>114</sup> The Commission also proposed for comment amendments to the registration form for open-end management investment companies under the Investment Company Act and the Securities Act to modify the prospectus disclosure requirements for deferred sales loads.

*Foreign Custody.* In July 1995, the Commission proposed for comment amendments to Rule 17f-5, which governs the custody of investment company assets outside the United States.<sup>315</sup> The proposed amendments would (a) revise the findings that currently must be made in establishing foreign custody arrangements to focus

exclusively on the safekeeping of investment company assets, (b) permit an investment company's board of directors to delegate its responsibilities under the rule to evaluate these arrangements, and (c) expand the class of foreign banks and securities depositories that could serve as investment company custodians. The amendments are designed to reduce the burdens currently placed on investment company directors in reviewing foreign custody arrangements and to provide investment companies with significantly more flexibility to select foreign custodians without sacrificing investor protection.

*Personal Investment Activities.* In September 1995, the Commission proposed for comment amendments to Rule 17J-1 under the Investment Company Act, Rule 204-2 under the Investment Advisers Act of 1940 (Investment Advisers Act), and investment company registration forms under the Investment Company Act and the Securities Act.<sup>116</sup> The proposed amendments would effect the recommendations made by the staff in connection with its 1994 study of the personal investment activities of investment company personnel by enhancing investment company oversight of personal investment activities, requiring public disclosure of personal investment policies, and making the scope of Rule 17J-1 more consistent with its purpose.

*Rule 24f-2.* In February 1995, the Commission proposed for comment amendments to Rule 24f-2 and new Form 24F-2.<sup>117</sup> Rule 24f-2 permits open-end investment companies to register an indefinite number of shares under the Securities Act, to net redemptions against sales in determining Securities Act registration fees, and to pay registration fees on an annual basis. The amendments are designed to clarify the application of certain provisions of Rule 24f-2, to make the rule's filing deadlines more flexible under certain circumstances, to improve the accuracy of information required to be filed under Rule 24f-2, and to improve the

agency's ability to process the filings. The amendments were approved by the Commission in September 1995.

*Quarterly Report Proposal.* In July 1995, the Commission proposed for comment new Rule 30b3-1, which would require money market funds to file electronically with the Commission quarterly reports detailing their portfolio holdings.<sup>118</sup> The information in the proposed reports would substantially improve the ability of the examination staff to monitor money market funds for compliance with the Investment Company Act.

*Safe Harbor.* In July 1995, the Commission proposed for comment new Rule 3a-4, which would provide a safe harbor from the definition of investment company for certain programs under which professional portfolio management services are provided to numerous individual clients.<sup>119</sup> If adopted, the rule would establish a non-exclusive method by which such programs can operate without being subject to the requirements of the Investment Company Act.

#### *Exemptive Orders, No-Action Letters, and Interpretations*

In 1995, the Commission issued exemptive orders permitting, among other things, investment advisers of multi-manager funds to hire sub-advisers without shareholder approval, the operation of "funds of funds," and the sale of interests in unit investment trusts subject to a non-contingent deferred sales load. The staff issued no-action letters and interpretations under the Investment Company Act concerning, among other things, aggregated trades, segregation requirements for short selling, joint borrowing arrangements, foreign custody, issuers of asset-backed securities, and affiliated transactions.

*Sub-advisers.* The Commission issued orders permitting certain investment advisers to multi-manager investment companies to hire

sub-advisers for the funds and to make material changes to sub-advisory contracts without approval by the funds' shareholders, provided that shareholders are provided with an information statement containing substantially all information that would otherwise be included in a proxy statement concerning new sub-advisers and material changes to the sub-advisory contracts. In addition, the orders allow the funds to disclose sub-advisory fees for each fund in their prospectuses and other reports in the aggregate, without separately disclosing each sub-adviser's fee.<sup>120</sup>

*"Funds of Funds."* The Commission issued orders permitting certain mutual funds to operate as "funds of funds"—funds that invest their assets in affiliated investment companies.<sup>121</sup> The orders supersede prior orders<sup>122</sup> and permit the funds to acquire up to 100 percent of the voting shares of any mutual fund in the same family of funds. Congress is considering legislation that similarly would facilitate the operation of mutual funds that invest substantially all of their assets in other funds in the same fund family.<sup>123</sup>

*Unit Investment Trusts.* The Commission issued orders permitting certain unit investment trusts (UITs) to be sold subject to a non-contingent deferred sales load, provided the load is disclosed in the fee table in the UITs' prospectuses.<sup>124</sup>

*Aggregated Trades.* The staff stated that it would not recommend enforcement action under Section 17(d) of the Investment Company Act, Rule 17d-1 thereunder, or Section 206 of the Investment Advisers Act if an investment adviser aggregates trades on behalf of its mutual fund clients and other clients, including clients in which the adviser has a proprietary interest, provided that trades are aggregated and allocated fairly and equitably.<sup>125</sup>

*Segregation Requirements.* The staff, modifying an earlier position, stated that it would not recommend enforcement action

under Section 18(f) of the Investment Company Act if a fund that engaged in short selling maintained in a segregated account assets having a value that, when combined with the value of collateral deposited with a broker in connection with the short sale, equals the current market value of the security sold short<sup>126</sup> The staffs prior position required the segregated account to maintain assets at least equal in value to the current market value of the securities sold short but in no event less than the market value of the securities when they were sold short.

*Committed Line of Credit Arrangement.* The staff stated that it would not recommend enforcement action under Section 17(d) of the Investment Company Act or Rule 17d-1 thereunder if affiliated funds jointly entered into a committed line of credit arrangement with a bank to provide the funds with a source of cash to meet unanticipated redemption requests. The arrangement was subject to conditions designed to ensure that each fund's participation in the arrangement would be equitable and in the fund's best interests.<sup>127</sup>

*Custodial Arrangements.* The staff stated that it would not recommend enforcement action under Section 17(f) of the Investment Company Act or Rule 17f-5 thereunder if a closed-end fund held Russian equity securities under certain custodial arrangements that were not contemplated when Rule 17f-5 was adopted.<sup>128</sup> Under Russia's unique share registry system, equity securities of Russian issuers are maintained in book-entry form by registrars located throughout Russia. The fund's proposed arrangements included monitoring the registrars, enhancing oversight by the fund's board of directors, and providing prominent prospectus disclosure of the risks posed by the Russian registry system.

*Asset-backed Securities.* The staff issued a no-action letter that provided guidance regarding the scope of Rule 3a-7 under the Investment Company Act, which excludes certain issuers of asset-backed securities from the definition of investment company.<sup>129</sup> The staff emphasized that issuers relying on the rule must be engaged solely in the business of acquiring and holding eligible assets, as defined in the rule, and in activities "related or incidental" thereto, e.g., only those that support or further the entity's business of acquiring and holding eligible assets.

*Investment Series.* The staff stated that separate series of a series investment company should be treated as separate investment companies for purposes of Section 17 of the Investment Company Act, which generally prohibits transactions between funds and their affiliated persons and affiliated persons of such affiliated persons. The staff's position permitted a broker-dealer to engage in transactions with a particular series of a series investment company when an affiliate of the broker-dealer serves as sub-adviser to another series of the same company.<sup>130</sup>

*Separate Investment Accounts.* The staff stated that it would not recommend enforcement action if a fund's total return, as quoted in its prospectus, statement of additional information, advertisements, and sales literature, included the performance of certain predecessor unregistered separate investment accounts (SIAs) for the periods prior to the effective date of the fund's registration statement.<sup>131</sup> Relief was based on the representations that the registered fund would be managed in a manner that is in all material respects equivalent to the management of the corresponding SIA, and that the SIAs were created for purposes entirely unrelated to the establishment of a performance record.

### *Insurance Company Matters*

The staff stated that it would not recommend enforcement action under Section 17(a) of the Securities Act and Rule 156 thereunder if certain variable annuity contracts used supplemental sales materials reflecting hypothetical rates of return illustrating both the accumulation and distribution periods.<sup>132</sup> The issuer has developed an interactive computer software program that permits investors to input personalized financial data and then to compare the hypothetical performance of the annuity with the hypothetical performance of mutual funds.

The Division clarified the application of Rule 24f-2 under the Investment Company Act to the two-tier arrangements used in offering variable insurance contracts to investors.<sup>133</sup> Under these arrangements, underlying funds may calculate and pay their Securities Act registration fees pursuant to Rule 24f-2 based on all of their sales and redemptions during the previous fiscal year, exclusive of sales to and redemptions from insurance company separate accounts that already paid such fees.

### *Disclosure Matters*

The Commission took several key initiatives to improve disclosures to investment company shareholders, including issuing a concept release and testing "profile" prospectuses. The most significant initiatives are described below.

*Risk Disclosure.* In March 1995, the Commission issued a concept release requesting comment on how investment companies could improve disclosure about their risks. To encourage individual investors to comment, the Commission also issued with the release a summary targeted to individual investors. Over 3,700 comments were received and were being evaluated at year-end. The staff also

worked closely with several fund groups to develop simplified prospectuses by eliminating technical jargon and legal prose.

*Profile Prospectus.* In August 1995, the Commission permitted a test group of eight mutual fund groups to provide their investors with a "profile" prospectus, which would accompany the prospectus currently provided to investors. Each profile briefly outlines 11 disclosure items, including information regarding the fund's investment objectives; investment strategies; risks and appropriateness of investment; fees and expenses; past performance; investment adviser; and purchase, redemption, and distribution procedures. The use of profiles is being undertaken initially for a one-year test period to determine, among other things, whether investors find them helpful regarding investment decisions.

*Reporting of Expenses.* In July 1995, the Commission adopted amendments relating to the reporting of expenses by investment companies.<sup>134</sup> The amendments require investment companies to reflect as expenses certain of their liabilities paid by broker-dealers in connection with allocating brokerage transactions to such broker-dealers and liabilities reduced by certain expense offset arrangements. The amendments also require investment companies to disclose the average commission rate paid. The amendments are designed to enhance the information provided to investors so that they may be better able to assess and compare investment company expenses and yield information.

*Money Market Fund Short Form Prospectus.* In July 1995, the Commission proposed for comment amendments to Form N-1A, the form used by open-end investment companies to register securities.<sup>135</sup> The proposed amendments are designed to promote the use of money market fund prospectuses that are shorter, more informative, and readily understandable to investors.

### *Filings Reviewed*

In 1995, the staff reviewed 68 percent of the 2,321 new portfolios filed (however, more than 90 percent of new open-end and closed-end portfolios were reviewed), 84 percent of the 711 proxy statements filed, and 12 percent of the 15,258 post-effective amendments filed with the Commission. The post-effective amendments included 378 registration statements filed in connection with fund mergers, which are among the most complex filings made by investment companies. Increased merger activity by investment companies resulted in a 36 percent increase in the number of merger registration statements filed, all of which were reviewed. These figures include filings by insurance product separate accounts.

### **Significant Investment Advisers Act Developments**

#### *Rulemaking*

In February 1995, the Commission proposed for public comment new Rule 204-4 and Form ADV-B under the Investment Advisers Act that would require certain investment advisers to provide clients with an annual report regarding the brokerage commissions they pay and the advisers' receipt of research and other "soft dollar" benefits from those commissions.<sup>136</sup>

#### *No-Action Letters and Interpretations*

In 1995, the Division issued no-action letters and interpretations under the Investment Advisers Act concerning, among other things, registration and electronic recordkeeping.

*Registration*, The staff stated that it would not recommend enforcement action under Sections 203 and 208(d) of the Investment Advisers Act if certain affiliates of a registered investment adviser did

not themselves register as investment advisers under Section 203, where (a) the affiliates would not be providing any investment advice, (b) the affiliates and each of their employees would be deemed "associated persons" of the registered adviser when provided access to recommendations of the registered adviser, and (c) the staff would be provided with access to the books and records of the affiliates to the extent necessary to examine the business of the registered adviser.<sup>137</sup>

*Electronic Recordkeeping.* The staff stated that it would not recommend enforcement action under the recordkeeping rules under the Investment Advisers Act and Investment Company Act if advisers that use a service offering on-line access to research reports do not maintain hard copies of all reports consulted.<sup>138</sup>

### *Interagency Agreement*

The staff also participated in the drafting and negotiation of an agreement between the Commission and the Office of the Comptroller of the Currency to conduct joint examinations of national banks, and their subsidiaries that advise mutual funds, and the funds they advise. This agreement should minimize the burdens on such banks and bank-advised funds, reduce regulatory costs, and enable the staff to obtain access to certain bank records even though the bank itself is not registered as an investment adviser.

## **Significant Holding Company Act Developments**

### *Recent Study*

In June 1995, the Division issued a report, *The Regulation of Public Utility Holding Companies*, which describes the results of the staff's study of the regulatory framework of the Holding Company Act in light of recent developments in the gas and electric utility

industry.<sup>139</sup> The primary recommendation of the report is that Congress repeal the Holding Company Act conditioned upon the enactment of provisions (1) to ensure state regulators and the Federal Energy Regulatory Commission access to books and records of companies in multi-state, public utility systems and (2) to provide for federal audit authority and oversight of affiliate transactions. The report also includes legislative and administrative proposals intended to update and streamline the regulatory structure governing public utility holding companies.

### *Rulemaking*

The Commission adopted rule amendments that exempt from Commission review certain additional types of securities that both public utility and non-utility subsidiaries of registered holding companies may issue.<sup>140</sup> The Commission also proposed amendments to broaden the exemption to include all securities issued by a subsidiary company of a registered holding company.<sup>141</sup> The Commission further proposed a new rule that would exempt from Commission review the holding company system's investments in energy-related activities of amounts up to the greater of 15 percent of the holding company's total capitalization or \$50 million. The rule also would exempt without limit investments by registered gas companies in gas-related activities.<sup>142</sup>

### *Registered Holding Companies*

As of September 30, 1995, there were 15 public utility holding companies registered under the Holding Company Act. The registered systems were comprised of 97 public utility subsidiaries, 14 exempt wholesale generators, 35 foreign utility companies, 229 non-utility subsidiaries, and 47 inactive subsidiaries, for a total of 437 companies and systems with utility operations in 26 states. These holding company systems had aggregate assets of approximately

\$136 billion and operating revenues of approximately \$46 billion as of September 30, 1995.

### *Financing Authorizations*

During 1995, the Commission authorized registered holding company systems to issue approximately \$22.9 billion of financing authorizations, an increase of 31 percent over 1994. The total financing authorizations included \$4.9 billion of investments in exempt wholesale generators and foreign utility companies, an increase of 1,072 percent over 1994, and investments of \$172 million in enterprises engaged in energy management.

### *Examinations*

The staff examined 9 service companies and 1 special purpose corporation. The staff reviewed the accounting policies, cost determination procedures, intercompany transactions, and quarterly reports of these service companies and special purpose corporations. Through the examination program and by uncovering misallocated expenses and inefficiencies, the Commission's activities during 1995 resulted in savings to consumers of approximately \$18.5 million.

### *Applications and Interpretations*

In 1995, the Commission issued various orders under the Holding Company Act. Four of the most significant orders are described below.

*CINergy Corporation*, CINergy Corporation became a new registered holding company following the Commission's approval of its acquisition, through merger, of the Cincinnati Gas & Electric Company and PSI Resources, Inc.<sup>143</sup>

*Southern Company.* The Commission authorized the Southern Company to invest approximately \$179 million in a new subsidiary that will provide wireless communications services to both associate and nonassociate companies.<sup>144</sup> Also, the Commission approved a percentage limitation upon the new subsidiary's transactions with nonassociates based on the investment needed to provide services to associate and nonassociate companies, respectively. The Commission suggested its willingness to consider a more flexible standard in the area of diversification, consistent with the language of Section 11 (b)(1) of the Holding Company Act. In another decision, the Commission removed a revenue-based percentage limitation on the activities of an energy management subsidiary of a registered holding company. Cited, among other things, were the financial health of the subsidiary; the benefits that consumers had derived from its operations; and Congress' goal of encouraging energy security, efficiency, competition, and environmental quality, all of which are promoted by the energy management services industry.<sup>145</sup>

*Central and South West Corporation.* The Commission authorized Central and South West Corporation, a registered holding company, and its service company subsidiary, Central and South West Services, Inc. (CSW Services), to consolidate and centralize in CSW Services certain service and management activities that were previously conducted individually by the operating companies of the registered system. The Commission determined that (a) the procedures to be used to authorize, monitor, and control the rendering of services by CSW Services to the operating companies should be adequate to enable management to control the cost, quality, and level of services received from CSW Services, and (b) its approval of the restructuring did not preclude the state regulatory authorities from scrutinizing and disallowing the pass-through of costs in rates for services rendered by CSW Services.<sup>146</sup>

*Columbia Gas System, Inc.* The Commission approved the bankruptcy reorganization plan of the Columbia Gas System, Inc.<sup>147</sup> and, in light of the extensive disclosure available to investors, integrated its report on the plan therewith.

## **Compliance Inspections and Examinations**

*The Office of Compliance Inspections and Examinations, together with the regional office examination staff, conducts the nationwide compliance inspections and examinations program for regulated entities, as authorized by the Securities Exchange Act of 1934, the Investment Company Act of 1940, and the Investment Advisers Act of 1940. These entities include brokers, dealers, municipal securities dealers, self-regulatory organizations, transfer agents, investment companies, and investment advisers.*

### **Key 1995 Results**

In May 1995, the Commission consolidated its examination and inspection activities into the Office of Compliance Inspections and Examinations (OCIE). The responsibilities for these activities was previously divided between the Divisions of Market Regulation and Investment Management. The Commission created OCIE to streamline the examination process by consolidating the management of the activities; reducing duplication; and improving coordination with the regional office examination staff, the Division of Enforcement (Enforcement), and other regulatory agencies. The office will offer higher quality training for examiners, better use of resources, and improved planning of examination strategies.

The inspection staff undertook a number of initiatives to enhance the joint and cooperative efforts among foreign, federal, and state regulators and self-regulatory organizations (SRO) in conducting inspections and other oversight activities of regulated entities. The staff also identified ways to foster increased cooperative efforts among Commission examiners responsible for inspecting different

types of regulated entities. All of these joint and cooperative efforts have the objective of increasing the staff's effectiveness and productivity and enhancing investor protection.

Furthermore, the staff focused on methods to utilize limited examination resources as effectively as possible. For example, the emphasis of the examination program shifted toward a model that selects the registrants to examine based on risk factors, rather than a cyclical approach.

### **Investment Company and Investment Adviser Inspections**

During the year, the staff completed inspections of 348 investment company complexes and 1,075 investment advisers. In 82 percent of these inspections, the staff found deficiencies that needed correction. An additional seven percent of the inspections completed were referred to Enforcement for consideration of an investigation and possible enforcement action.

#### *Investment Companies*

During the year, examiners completed inspections of 348 investment company complexes with \$1.1 trillion under management, indicating an average frequency of inspection for the 969 investment company complexes of once every 2.8 years. The complexes inspected managed 3,144 portfolios, which represented approximately 51 percent of the mutual fund and closed-end fund portfolios in existence at the beginning of 1995. This indicated an average inspection frequency for mutual and closed-end funds of once every 2 years. The complexes inspected represented a mix of both large and smaller complexes. Forty-eight of the inspections were done on a "for cause" basis, which means the staff had some reason to conduct the inspection other than the simple passage of time.

Of the 348 inspections completed, 23 were referred to Enforcement. Of those referrals, 48 percent had problems related to net asset value calculations, 48 percent had problems related to internal controls, and 39 percent had problems related to prohibited transactions.

*Mutual Fund Administrators.* Approximately 43 percent of all mutual fund complexes use third party administrators to perform their accounting and administrative functions. Prior to 1995, administrators were inspected individually and during inspections of fund complexes. During 1995, the staff began a special program of comprehensive individual or stand-alone, inspections of these administrators to review their activities across their entire mutual fund client base. Examiners completed 25 inspections of administrators during the year. Of these, one was referred to Enforcement. The administrator inspections also resulted in the staff subsequently conducting three "for cause" examinations of investment company fund complexes.

*Variable Insurance Products.* In response to the rapid growth in variable insurance product assets and the emergence of new channels of distribution, five specialized insurance product examination teams were formed in OCIE and the regional offices during the year. These teams were charged with identifying and examining variable life and annuity contract separate accounts. The teams worked in conjunction with the Division of Investment Management (Investment Management) in the planning and execution of the examination program. During the year, 18 insurance company complexes were examined and deficiency letters were issued in each examination. The examinations revealed significant internal control weaknesses, as well as issues that were referred to Investment Management for comment.

*Bank Advised Mutual Funds.* The Commission and the Office of the Comptroller of the Currency signed an agreement on June 12, 1995 that provides for joint examinations of mutual funds advised by national banks and national banks that provide investment services to funds. As a result of this agreement, one joint examination was completed and a second was initiated. These two examinations focused on a review of key internal control areas as well as an analysis of portfolio transaction data relating to both mutual fund and trust department client trading. This represents the first time Commission examiners have been able to compare mutual fund trading to trading by other trust department clients to determine if there is evidence of overreaching or other abusive investment or trading practices.

#### *Investment Advisers*

During the year, the staff's general approach to targeting investment advisers for inspection was changed significantly to reflect the large growth in the number of advisers over the last several years and the lack of growth in the size of the inspection staff. These changes also recognize that the level of risk of loss to clients posed by different types of advisers varies greatly.

*New Inspection Approach.* Examinations focused on the advisers that appeared to pose a higher risk to clients, such as those that had actual custody of client funds and securities and those that had discretionary management authority over clients' cash and securities. Examiners in the regional offices were given the primary responsibility for conducting inspections of all discretionary managers and those non-discretionary managers with \$100 million or more under management as well as advisers with custody of client assets. Regional staff also were responsible for conducting all "for cause" inspections.

*Sweep Inspections.* Inspections of the remaining investment advisers became the responsibility of the Commission's headquarters staff. The staff conducted geographical sweep inspections of 90 investment advisers in Maryland, Washington, and Minnesota. State examiners in all three states were invited to participate. A majority of the advisers examined were financial planners. Typically, financial planners prepare financial plans that are implemented through sales of mutual funds by the planners in their capacity as a registered representative of a broker-dealer. Most planners also sell insurance products.

Under this new approach, the inspection staff completed 1,075 investment adviser inspections, including examinations of 893 advisers with discretionary management authority. The non-investment company assets managed by the advisers inspected totalled \$462 billion. The 893 inspections of discretionary advisers covered 11 percent of all such advisers, indicating an average inspection cycle for discretionary advisers of once every 8 to 10 years. The overall inspection cycle for advisers dropped from once every 22 years to once every 20 years.

Deficiency letters were sent in 75 percent of the examinations, 10 percent were concluded with a conference call, and 1 percent was referred to Enforcement. Deficiencies found during inspections were concentrated in books and records and brochure disclosures. No deficiencies were found in 14 percent of the inspections.

Of the 177 "for cause" examinations, 70 were referred to Enforcement. Of the referrals, 60 percent had problems related to custody of client funds or securities, 58 percent had problems involving conflicts of interest, and 51 percent had problems related to marketing or performance advertising.

## **Broker-Dealer Examinations**

During the year, the OCIE focused on and expanded the activities of the broker-dealer examination program, initiating and coordinating projects focused on particular areas of regulatory concern, such as the recent Joint Regulatory Sales Practice Examination Sweeps, a follow-up to the *Large Firm Report* by the Divisions of Market Regulation and Enforcement.

The staff conducted a sales practice sweep of small and medium-sized brokerage firms designed to review the hiring, retention, and supervisory practices of both New York Stock Exchange (NYSE) and National Association of Securities Dealers, Inc. (NASD) member firms, as well as the sales practices of identified registered representatives employed by these firms. The sweep was a collaborative effort by the Commission, the NYSE, the NASD, and the North American Securities Administrators Association. The objective of the sweep was to identify problem brokers, and to ensure that appropriate supervisory mechanisms are in place or, where necessary, to take appropriate enforcement action against these individuals. The staff completed 179 examinations at 101 different firms and was analyzing the findings of the examinations at fiscal year-end.

The staff also completed a total of 662 examinations of brokers, dealers, and municipal securities dealers consisting of 393 oversight examinations and 269 "for cause" examinations. Findings from 158 examinations were referred to the Division of Enforcement for further consideration. Referrals to SROs were made in 42 examinations. Many of these examinations focused on areas of recent concern to the Commission, such as broker-dealers' internal controls. As a result, the staff developed and tested a module to be used to review

the internal controls of broker-dealers. The module covers internal audit, senior management, trading, funding and liquidity, credit controls, new products, physical premises, SRO examination and workpapers, and financial information analysis. The module was used in a number of comprehensive examinations of broker-dealers' internal controls.

## **SRO inspections and Oversight**

The staff adopted "Guiding Principles" for conducting SRO inspections. These principles include coordinating various SRO inspection teams to ensure consistent reviews and recommendations, to expedite the inspection process, to develop tracking systems to monitor and track SRO programs, and to provide follow up to recommendations made in inspection reports. In addition, inspection teams will meet regularly with all SROs not only to follow up on recommendations of inspection reports, but also to ensure that important issues of mutual interest are discussed with the SROs.

The staff completed routine oversight inspections of the enforcement and sales practice examination programs of the NYSE and the Chicago Board Options Exchange (CBOE), as well as the sales practice investigations program of the CBOE. The market surveillance, investigatory, and disciplinary programs of the Boston Stock Exchange (BSE), the CBOE, the Chicago Stock Exchange (CHX), the NYSE, the Pacific Stock Exchange (PSE), and the Philadelphia Stock Exchange (Phlx) were inspected. The staff also inspected the arbitration programs of the NASD and the NYSE and started inspections of the arbitration programs of the Municipal Securities Rulemaking Board (MSRB) and the PSE.

Examiners completed several special purpose inspections, which included the American Stock Exchange's (Amex) listing program and the NASD's Public Disclosure Program; the audit trail

systems of the Amex, the CBOE, the NASD, and the NYSE; the BSE's pilot competing specialist initiative; and the Cincinnati Stock Exchange's (CSE) pilot preferencing program. The staff started an inspection of the NASD's enforcement, waiver, surveillance, and examination program for broker-dealer compliance with MSRB Rule G-37.

Routine oversight inspections of the regulatory programs administered by the NASD's 14 district offices were conducted. These inspections included reviews of eight district offices' broker-dealer examination, financial surveillance, and formal disciplinary action programs, as well as investigations of customer complaints, terminations of registered representatives "for cause," and members' notices of disciplinary action against their own employees.

Five clearing agencies were inspected: the Government Securities Clearing Corporation, Philadelphia Depository Trust Company, Stock Clearing Corporation of Philadelphia, Midwest Securities Trust Company, and Midwest Clearing Corporation.

### *SRO Final Disciplinary Actions*

Section 19d-1 of the Securities Exchange Act of 1934 and Rule 19d-1 thereunder require all SROs to file reports with the Commission of all final disciplinary actions. In 1995, the SROs filed 1,105 reports. The Amex filed 14 reports, the BSE filed 1 report, the CBOE filed 46 reports, the CHX and the CSE filed none, the NASD filed 827 reports, the National Securities Clearing Corporation filed 5 reports, the NYSE filed 183 reports, the Options Clearing Corporation filed 3 reports, the Phlx filed 24 reports, and the PSE filed 2 reports.

## **Full Disclosure System**

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

### **Key 1995 Results**

Reflecting a significant increase in transactions in the latter half of the year, the \$824 billion in securities filed for registration during the year represented a slight increase over the \$815 billion in 1994. Common stock offerings of nearly \$400 billion filed for registration in 1995 (compared to \$333 billion in 1994) reflected a substantial increase in merger activity, as well as a modest increase in stock offerings. Offerings filed by first time registrants (IPOs) totalled approximately \$82 billion, nearly level with 1994.

Foreign companies' participation in the United States public market continued to show strong growth in 1995. One hundred and eighteen foreign companies from 28 countries, including Royal Bank of Canada, Jilin Chemical Company (China), PowerGen plc and National Power plc (United Kingdom), CRVD (Brazil), Asia Pulp and Paper (Singapore), Portugal Telecom and Jefferson Smurfit plc (Ireland), entered the United States public markets for the first time. At year-end, there were 709 foreign companies from 43 countries filing reports with the Commission. Foreign companies registered public offerings of \$41 billion in 1995.

[table deleted]

In the rulemaking area, a package of initiatives was published for comment by the Commission to streamline and enhance the utility of disclosure. The proposals would allow the use of abbreviated or summary financial information in disclosure documents delivered to investors, streamline director and executive compensation disclosure in annual proxy and information statements, raise the total assets threshold for Securities and Exchange Act of 1934 (Exchange Act) registration, reduce the holding period requirements in Rule 144 under the Securities Act of 1933 (Securities Act), and exempt from federal registration small offerings that are exempt under a California law.

The Commission also revised its prospectus delivery and other rules to facilitate compliance with prospectus delivery requirements with the change to a three business day settlement period for securities transactions (T+3). Use of electronic media to deliver mandated disclosure documents was addressed and facilitated by the issuance of an interpretive release providing guidance and a degree of certainty to issuers that use electronic media to deliver or transmit information to investors.

In addition, broad-based initiatives are being considered that may result in substantial revisions to the registration and disclosure processes. In 1995, the Commission established an Advisory Committee on the Capital Formation and Regulatory Processes, reflecting the Commission's continuing efforts to minimize regulatory burdens while maximizing investor protection. The Committee is considering fundamental issues relating to the regulatory framework governing the capital formation process, such as whether Commission rules should provide for registration of companies rather than securities.

An internal Task Force on Disclosure Simplification undertook a "top to bottom" review of all forms and disclosure requirements relating to securities offerings and disclosure obligations of public companies. The purpose of the review is to streamline and simplify regulations, including the elimination of any requirements that have outlived their usefulness.

In 1995, the staff reviewed 30.8% of the reporting issuers, as well as 1,150 Securities Act and Exchange Act registration statements of first time filers.

### **Review of Filings**

The following table summarizes the principal filings reviewed during the last five years. The levels of reviews of new issuer filings, tender offers, contested solicitations, and going private transactions, all of which are subject to review, reflect the increases and decreases in the number of filings received.

[table deleted]

### **Rulemaking, Interpretive, and Legislative Matters**

#### *Prospectus delivery in connection with T+3 settlement*

The Commission proposed and adopted amendments to its rules and forms, as well as a new rule under the Securities Act, in order to implement two solutions to prospectus delivery timing issues arising in connection with the change to T+3 securities transaction settlement.<sup>148</sup> The amendments and rule are based on recommendations submitted by representatives of financial intermediaries. Among other things, the initiatives for the first time allow prospectus disclosure to be completed through the use of supplements to prospectuses subject to completion (*i.e.*, term sheets)

and the confirmation of sale. In addition, the Commission amended an exemption from T + 3 clearance and settlement for purchases and sales of securities pursuant to a firm commitment offering. This exemption is now limited to offerings in which an alternative settlement cycle is agreed to by the issuer and the underwriter.

### *Electronic delivery of documents to security holders*

The Commission issued an interpretive release<sup>149</sup> and related rule proposals<sup>150</sup> addressing the use of electronic media to deliver or transmit to investors information under the federal securities laws. The interpretive release provides guidance and a degree of certainty to issuers who use electronic media in complying with the applicable delivery requirements of the federal securities laws. The interpretive release also contains numerous examples applying these concepts to specific fact situations and solicits comment on various matters to assist the Commission in evaluating the need for additional interpretations. The rule proposals include a number of technical amendments to the Commission's rules and forms that are intended to codify some of the interpretations set out in the interpretive release.

### *June 1995 Initiatives*

On June 27, 1995, the Commission issued eight releases, seven proposing rule changes and one stating interpretive positions, to streamline disclosure, facilitate capital raising, and deter abusive practices.

#### *1. Abbreviated Financial Statements*

The Commission issued a release proposing new rules and amendments that would allow the use of abbreviated financial statements in annual reports to shareholders and other disclosure

documents that are delivered to investors, such as prospectuses, proxy and information statements, and documents furnished to investors in connection with tender offers or going private transactions.<sup>151</sup> The release also seeks comment on other approaches to streamlining the annual report to shareholders, such as permitting the use of a summary annual report, or allowing registrants total flexibility by rescinding the Commission's requirements for delivery of an annual report to shareholders.

## *2. Streamlining Delivery of Executive and Director Compensation Disclosure*

The Commission proposed amendments to Item 402 of Regulation S-K and Regulation S-B to streamline executive compensation disclosure in annual proxy and information statements and to reformat director compensation disclosure.<sup>152</sup> The amendments would permit registrants to furnish the detailed executive compensation disclosure currently required to be provided in the proxy or information statement, in the annual report on Form 10-K. The proposed amendments also would replace the current narrative disclosure of several common elements of director compensation with a new tabular presentation in the proxy statement

### *3a Small Offering Exemption for Certain California Limited Issues*

The Commission issued a release proposing a new Securities Act Section 3(b) exemption from the registration requirements of the federal securities laws.<sup>153</sup> Under the proposed exemption, offers and sales of securities in amounts of up to \$5 million, that satisfy the conditions of a recently-enacted exemption from California state qualification requirements, also would be exempt from federal registration. The federal antifraud prohibitions would continue to apply to all such exempt transactions. The proposed exemption would provide that purchasers in the exempt transaction receive

"restricted securities." No filing with the Commission would be required.

### *3b, Solicitation of Comment Concerning Prohibitions Against General Solicitations in Exempt Offerings*

In light of the California Exemption, which allows general solicitations so long as sales are effected only to qualified purchasers, the Commission also solicited comment on whether general solicitations should be permitted in Regulation D and private placements.<sup>154</sup> The release includes questions about whether Regulation D should allow general solicitations, who should be able to use them, and the extent to which the content of such communications should be restricted,

### *4. Solicitations of Interest Prior to an Initial Public Offering*

The Commission issued proposals that would allow many issuers that are not subject to Exchange Act reporting requirements to "test the waters" for interest in their company prior to the preparation and filing of an IPO registration statement under the Securities Act.<sup>155</sup> The proposed rule is intended to allow an issuer with no established market for its securities to assess potential investor interest in the company before incurring the costs associated with the preparation of a Securities Act registration statement. The proposal would require that written solicitation documents or broadcast scripts be submitted to the Commission on or before first use. If, after "testing the waters," an issuer decided to proceed with a registered IPO, it would have to file a registration statement and provide investors with a prospectus. "Test the waters" solicitations would have to be discontinued once a registration statement was filed. Sales of securities would not be allowed until 20 calendar days after the last publication or delivery of the document or broadcast. Regulation A would be amended where appropriate so

that its "test the waters" provisions would operate in a parallel fashion.

#### *5. Relief From Section 12(g) Registration for Small Issuers*

The Commission proposed amendments to its rules under the Exchange Act governing the total assets threshold for entry into and exit from the full disclosure system.<sup>156</sup> Under the proposals, issuers would be required to register pursuant to Section 12(g) of the Exchange Act if they have 500 shareholders of record and \$10 million in total assets, an increase from the current asset threshold of \$5 million. Rules relating to exiting from the Exchange Act reporting system also would be revised to allow issuers to cease reporting if they drop below a total assets threshold of \$10 million wherever the present standard is \$5 million.

#### *6. Reduction of Rule 144 Holding Period*

The Commission proposed amendments to the holding period requirements contained in Rule 144 under the Securities Act to permit resales of "restricted" securities after a one-year, rather than a two-year holding period.<sup>157</sup> Also under the proposal, securities held by non-affiliated security holders could be resold without restriction after a holding period of two, rather than three years. These proposals are designed to decrease the costs associated with private capital raising by reducing the discount arising from the length of the holding period. The Commission also requested comment on whether Rule 144 should be revised to address new trading strategies, such as equity swaps and reminded Section 16 insiders of their obligations to report equity swap transactions.

### *7a. Streamlining Disclosure Requirements Relating to Significant Business Acquisitions*

The Commission issued a release proposing amendments to the financial statement requirements for significant acquisitions to eliminate the requirements to provide audited financial statements for pending and recently completed business acquisitions in Securities Act registration statements, other than registrations by "blank check companies."<sup>158</sup> The proposed rules are intended generally to allow issuers to provide information about significant acquisitions in Securities Act registration statements on the same time schedule as for Exchange Act reporting, thereby alleviating the need for such issuers to forego public offerings and to undertake private or offshore offerings. In addition, the proposed rules would provide an automatic waiver of the earliest year of required financial statements for completed acquisitions that do not exceed a specified significance level, if such audited financial statements are not readily available.

### *7b. Quarterly Reporting of Unregistered Equity Sales*

In connection with a review of offshore capital raising practices, the Commission proposed amendments to its annual and quarterly reporting forms for domestic issuers that would require disclosure of unregistered sales of equity securities during the previous fiscal quarter.<sup>159</sup> The proposed amendments are limited to unregistered sales of common equity securities (and common equity equivalents) because of the significant market impact the issuance of such securities often has and the current lack of public information about such sales.

## *8 Problematic Practices Under Regulation S*

The Commission issued an interpretation of Regulation S stating its views with respect to certain practices in connection with offers,

sales and resales of securities purportedly made in offshore transactions in reliance on Regulation S.<sup>160</sup> The release discusses transactions in which circumstances indicate that securities are in essence being placed offshore temporarily to evade registration requirements with the result that the incidence of ownership of the securities never leaves the U.S. market or that a substantial portion of the economic risk relating thereto is left in or is returned to the U.S. market during the restricted period, or the transaction is such that there was no reasonable expectation that the securities could be viewed as actually coming to rest abroad. The release states that such transactions would not be covered by Regulation S or the safe harbors and would be found not to be an offer and sale outside the U.S. for purposes of the general statement, which provides that the regulatory requirements under Section 5 of the Securities Act shall be deemed not to apply to offers and sales of securities that occur outside the U.S.

The release also solicits comments on the need to amend Regulation S to deter abuses and requests general comments as to which types of companies are using Regulation S, how they are using it, and what mechanisms can be used to prevent abuse. The Commission specifically requested comment as to whether it should propose amendments to the safe harbor for primary offerings of domestic companies reporting under the Exchange Act that would (1) extend the 40-day restricted period, (2) exclude certain discounted offers, (3) restrict hedging and other risk shifting transactions during the restricted period, or (4) prohibit payment with certain types of non-recourse or other types of promissory notes where the expectation of repayment derives solely from the resale of securities.

## *Section 16*

The Commission issued a release proposing amendments to the Section 16 rules,<sup>161</sup> as part of its continuing effort to improve the regulatory scheme governing the reporting of certain insider holdings and transactions, as well as the recovery of short-swing profit. In 1994, the Commission solicited public comment on proposed amendments to this regulatory scheme,<sup>162</sup> and solicited further comment in September 1994 as to the treatment of instruments that may be settled only in cash.<sup>163</sup> The most recent release proposes an alternative amendment to Rule 16b-3 that would exempt virtually all transactions between an issuer and its officers and directors, in addition to an amendment to the rule exempting transactions in dividend or interest reinvestment plans that would reduce regulatory burdens. Comment also was solicited as to whether the Commission should recommend that Congress rescind Section 16(b) of the Exchange Act. The comment period on the earlier releases was extended to comport with the close of the comment period relating to this release, and both the 1994 and 1995 proposals will be considered by the Commission.

### *Electronic Data Gathering, Analysis, and Retrieval System (EDGAR)*

In view of the statutory requirement that the Commission certify that electronic filings from a significant test group of filers were received and reviewed for a period of six months before mandating electronic filing for all registrants, the staff undertook a comprehensive study of the test period results. Following its review of the study, which concluded that provision of information through the EDGAR system is at least as efficient and effective as through paper filings, the Commission adopted as final the rules that had been applicable to electronic filing during the statutorily mandated significant test period and made them applicable to all domestic

registrants and third parties filing with respect to those registrants.<sup>164</sup> Phase-in of registrants into the electronic filing system recommenced on January 30, 1995, and proceeded as outlined in a revised phase-in schedule, with completion of phase-in set for May 1996. Minor amendments to the electronic filing rules also were adopted to reflect the staff's experience with the rules since mandated electronic filing began in 1993. On September 28, 1995, the Commission instituted its Internet World Wide Web site, which includes EDGAR filings as well as certain Commission releases and announcements.

### *Public Hearings on Safe Harbor for Forward-looking Statements*

The Commission issued a concept release in 1994 regarding disclosure of forward-looking information and the effectiveness of the safe-harbor provisions for that type of disclosure.<sup>165</sup> The release solicited comment from the public on various alternatives to the safe harbor provision that have been proposed by several persons and announced public hearings to address these issues further in a public forum. The hearings were held in Washington, D.C, on February 13, 1995, and in San Francisco, California on February 16, 1995.

### *Legal Proceedings Involving Directors, Executive Officers, Significant Shareholders and Others*

The Commission proposed amendments that would expand disclosure requirements relating to legal proceedings involving management, promoters, control persons, and others by enlarging the classes of legal proceedings that are subject to disclosure and by extending the period during which such disclosure is required from the current five to ten years.<sup>166</sup> The proposals also would make uniform all such requirements found in various forms, schedules, and reports.

## **Conferences**

### *SEC Government-Business Forum on Small Business Capital Formation*

The fourteenth annual SEC Government-Business Forum on Small Business Capital Formation was held in Providence, Rhode Island on September 13-14, 1995. Approximately 150 small business representatives, accountants, attorneys, and government officials attended the forum. Numerous recommendations were formulated with a view to eliminating unnecessary governmental impediments to small businesses' ability to raise capital. A final report will be provided to interested persons, including Congress and regulatory agencies, setting forth a list of recommendations for legislative and regulatory changes approved by the forum participants.

### *SEC/NASAA Conference Under Section 19(c) of the Securities Act*

The twelfth annual federal/state uniformity conference was held in Washington, D.C. on March 27, 1995. Approximately 60 SEC officials met with approximately 60 representatives of the North American Securities Administrators Association 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 and participants.

## **Committees and Task Forces**

### *Advisory Committee on Capital Formation*

In 1995, the Commission established an Advisory Committee on the Capital Formation and Regulatory Processes, reflecting the Commission's continuing efforts to minimize regulatory burdens while maximizing investor protection. The Committee is considering

fundamental issues relating to the regulatory framework governing the capital formation process, such as whether Commission rules should provide for registration of companies rather than securities.

*Task Force on Disclosure Simplification*

An internal Task Force on Disclosure Simplification initiated a "top to bottom" review of all forms and disclosure requirements relating to securities offerings and disclosure obligations of public companies. The purpose of the review is to streamline and simplify regulations, including the elimination of any requirements that have outlived their usefulness.

## **Accounting and Auditing Matters**

*The Chief Accountant is the principal adviser 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 and interpretation that supplements private-sector accounting standards, implements financial disclosure requirements, and establishes independence criteria for accountants;*
- review and comment process for agency 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 financial accounting and reporting and the quality of audit practice.*

## **Key 1995 Results**

The Commission continued its involvement in initiatives directed toward reducing the disparities that currently exist between different countries' accounting and auditing standards. During 1995, the International Accounting Standards Committee (IASC) developed a work plan that, upon successful completion would result in a comprehensive core set of international accounting standards. Target date for completion of the work plan is June 1999; however, efforts are underway to accelerate that timetable, possibly by as much as a year.

## **Accounting-Related Rules and Interpretations**

The agency's accounting-related rules and interpretations supplement private-sector accounting standards, implement financial disclosure requirements, and establish independence criteria for accountants. The agency's principal accounting requirements are embodied in Regulation S-X, which governs the form and content of financial statements filed with the SEC.

*Debt Extinguishment.* The staff issued interpretive guidance regarding the period in which a gain or loss should be recognized on the early extinguishment of debt.<sup>167</sup> The guidance was issued in response to divergent reporting practices by public companies by which certain companies were recognizing such a gain or loss in a period earlier than the period in which the debt is considered extinguished.

## **Oversight of Private-Sector Standard-Setting**

The SEC monitors the structure, activity, and decisions of the private-sector standard-setting organizations, which include the FASB. The Commission and its staff worked closely with the FASB in

an ongoing effort to improve the standard-setting process, including the need to respond to various regulatory, legislative, and business changes in a timely and appropriate manner. A description of FASB activities in which the staff was involved is provided below.

During 1995, the FASB completed work on an exposure draft of a proposed standard that would specify when entities should be included in consolidated financial statements.<sup>168</sup> The proposed standard would require a controlling entity to consolidate all entities deemed to be under its control unless such control is temporary. For purposes of this requirement, control of an entity is defined as representing the power to use or direct the use of the individual assets of another entity in essentially the same ways as the controlling entity can use its own assets. If adopted as proposed, the new standard would represent a significant change from existing practice in which consolidation policy generally is based on the existence of majority voting interests.

In another consolidations-related project, the FASB continued its joint undertaking with the Accounting Standards Board of the Canadian Institute of Chartered Accountants (CICA) to consider the current reporting requirements under *Statement of Financial Accounting Standards No. 14*, "Financial Reporting for Segments of a Business Enterprise." An exposure draft that would establish common standards on disaggregated disclosures was issued after year-end.

In 1995, the FASB adopted a new standard on accounting for impairment of long-lived assets.<sup>169</sup> Under the new standard, long-lived assets and certain identifiable intangibles to be held and used by an entity are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. The approach set forth in the new

standard is referred as a "two-step" method because the test for recognition of impairment is different than the measurement of the impairment loss. Recognition of impairment occurs if the sum of the future cash flows expected to result from the use of the asset and its eventual disposition (an undiscounted measure) is less than the asset's carrying amount. However, the impairment loss would be measured by the amount by which the asset's carrying amount exceeds its fair value. The standard represents the culmination of a long range project that is expected to narrow the range of divergent financial reporting practices in this area.

The FASB also issued a final standard on accounting for stock compensation.<sup>170</sup> Statement 123, *Accounting for Stock-Based Compensation*, encourages companies to adopt a new accounting method that recognizes the cost of stock option awards based on estimated fair value at grant date. Alternatively, companies may elect to continue to follow the existing accounting requirements set forth in Accounting Principles Board Opinion No. 25, which generally do not result in an expense charge for most options. Companies electing to continue to apply Opinion 25 would be required to provide footnote disclosure of the effect on net income had the company recognized expense based on estimated fair value at grant date. The statement becomes effective for calendar year 1996.

The FASB made progress during 1995 on its major long-term project to address financial instruments and off-balance sheet financing issues. The FASB is pursuing an approach to accounting for derivative instruments and hedging that it believes would improve the current accounting for those instruments. Under the FASB's approach, entities would select among two options, both of which would rely on fair value measurements. The determination of fair value would be based on the valuation guidance provided in FASB Statement 107, *Disclosures about Fair Value of Financial*

*Instruments*, adopted in an earlier phase of this project. In a related action, the FASB issued an exposure draft to provide for more consistent reporting of securitizations and other financial transactions in which financial assets are transferred in exchange for cash or other assets.<sup>171</sup> The proposed standard addresses determining when financial assets should be considered sold and derecognized from the balance sheet and when related revenues and expenses should be recognized.

During 1995, Congress considered litigation reform issues that impact the accounting profession. These issues include, among others, class action reforms, the shifting from one party to another of litigation costs and expenses, proportionate liability, substantive standards for accountants' liability, and safe harbors for disclosures of forward-looking information. The Senate bill and the House of Representatives bill took different approaches to these issues.<sup>172</sup> Both bills, however, included provisions that would (1) codify the Commission's authority to set auditing standards related to illegal acts, related party transactions, and the evaluation of an entity as a going concern and (2) require auditors to report certain uncorrected illegal acts of registrants to the Commission. The Private Securities Litigation Reform Act of 1995 which included these provisions was enacted after year- end.

In addition, the Commission has responded to Congressional interest in streamlining disclosure requirements<sup>173</sup> by, among other things, initiating a project to reexamine Regulation S-X for possible outdated accounting provisions or provisions that may not be necessary because they duplicate generally accepted accounting principles.

Finally, Congressional interest in the accounting for derivative instruments continued in 1995. Commission testimony stressed the

need for sound financial statements of issuers of derivative instruments.<sup>174</sup>

The FASB's Emerging Issues Task Force (EITF), in which the Commission's Chief Accountant participates, continued to identify and resolve accounting issues. During 1995, the EITF reached consensus on a number of issues, including questions relating to accounting for financial instruments, revenue recognition, and business combinations, thereby narrowing divergent reporting practices of public companies. Also during 1995, the EITF formed an Agenda Committee in response to recommendations made by an FASB Committee to Review the EITF.

### **Oversight of the Accounting Profession's Initiatives**

The Commission and its staff continued to be active in overseeing the auditing standard-setting process and other activities of the accounting profession. A discussion of the activities in which the SEC staff was involved follows.

*AICPA.* The SEC oversaw various activities of the accounting profession conducted primarily through the AICPA. These included (1) the Auditing Standards Board (ASB), which establishes generally accepted auditing standards; (2) the Accounting Standards Executive Committee (AcSEC), which provides guidance through its issuance of statements of position and practice bulletins and prepares issue papers on accounting topics for consideration by the FASB; and (3) the SEC Practice Section (SECPS), which seeks to improve the quality of audit practice by member accounting firms that audit the financial statements of public companies through various requirements, including peer review.

*ASB.* The staff continued to work closely with the ASB to enhance the effectiveness of the audit process. The ASB issued a

series of annual Audit Risk Alerts to provide auditors with an overview of recent economic, professional, and regulatory developments that may affect 1995 year-end audits.

*SECPS.* Two programs administered by the SECPS are designed to ensure that the financial statements of SEC registrants are audited by accounting firms with adequate quality control systems. A peer review of member firms by other accountants is required every three years and the Quality Control Inquiry Committee (QCIC) reviews on a timely basis the quality control implications of litigation against member firms that involves public clients. The staff coordinates closely with the Public Oversight Board (POB) in performing its oversight of the two programs. The POB, which is independent of the AICPA (except for funding), also engages in other activities directed towards improvements in the financial reporting process.<sup>175</sup>

The Commission exercises oversight of the SECPS through frequent contacts with the POB and members of the executive, peer review, and QCICs of the SECPS. The staff each year selects a random sample of peer reviews and evaluates selected working papers of the peer reviewers and the related POB files. 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,

Closed case summaries prepared by the QCIC and related POB oversight files are also reviewed by SEC staff. This review and discussions with the POB and QCIC staff provide SEC staff with enough information to conclude that the QCIC process provides added assurances, as a supplement to the peer review process, that major quality control deficiencies, if any, are identified and addressed

on a timely basis. Therefore, the Commission believes that the QCIC process benefits the public interest.

*AcSEC.* The AcSEC issued a statement of position calling for enhanced footnote disclosures about risks and uncertainties.<sup>176</sup> Also during 1995, the AcSEC issued an exposure draft of a proposed accounting guide on environmental liabilities.<sup>177</sup>

*Special Committee.* In addition, the AICPA's Special Committee on Financial Reporting issued a comprehensive report which focuses on the financial information needs of users.<sup>178</sup> The report of the Special Committee, also referred to as the "Jenkins" Committee in recognition of its chairman, Edmund Jenkins, makes certain recommendations to enhance the utility of business reporting. However, since the Special Committee is not a standard-setting body, its recommendations will be considered by accounting standard setters, predominately the FASB and by regulators, such as the SEC. The FASB plans to issue an Invitation to Comment on the recommendations of the Special Committee, as well as those made by the Association for Investment Management and Research (AIMR) in its White Paper entitled "Financial Reporting in the 1990s and Beyond."

### **International Accounting and Auditing Standards**

Significant differences in accounting and auditing standards currently exist between countries. These differences are an impediment to multinational offerings of securities. The SEC, 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. In 1995, the IASC issued a standard on disclosure and presentation of financial instruments.<sup>179</sup> Work also

continued on major projects addressing recognition and measurement issues related to financial instruments.<sup>180</sup> earnings per share,<sup>181</sup> intangible assets,<sup>182</sup> reporting financial information by business segments,<sup>183</sup> income taxes,<sup>184</sup> presentation of financial statements,<sup>185</sup> and accounting for retirement and other employee benefit costs.<sup>186</sup>

In August 1993, the Working Party informed the IASC of the necessary core accounting standards that would comprise a comprehensive body of principles for enterprises (not in a specialized industry) undertaking cross-border offerings and listings. In June 1994, the Working Party provided the IASC with its evaluation of the acceptability of existing and recently improved IASC standards and identified the projects that would be necessary to complete the development of a core set of standards. In July 1995, the IASC and IOSCO's Technical Committee announced that the Board of the IASC has developed a work plan that the Technical Committee agrees will result, upon successful completion, in International Accounting Standards (IAS) comprising a comprehensive core of standards. Completion of comprehensive core standards that are acceptable to the Technical Committee will allow the Technical Committee to recommend endorsement of IAS for cross-border capital raising and listing purposes in all global markets. Completion of the work plan is estimated to be June 1999. Efforts are underway to accelerate that work plan, possibly by as much as a year.

In addition to the existing projects in process, the work plan includes planned projects on accounting in interim periods, discontinued operations, provisioning and contingencies, leases, research and development, impairment, investments, and goodwill.

In December 1994, the Commission eliminated the need to reconcile the differences that would result from the application of

SFAS No. 52, *Foreign Currency Translation*, if the issuer accounts for its operations in hyperinflationary economies using the historical cost/constant currency method in accordance with IAS 21, *The Effects of Changes in Foreign Exchange Rates*.<sup>187</sup> This followed a 1994 action in which the Commission revised financial statement requirements so that foreign private issuers may now submit, without reconciliation, a cash flow statement prepared in accordance with IAS 7, *Cash Flow Statements*. Also, the Commission proposed to eliminate the requirements to reconcile certain differences attributable to the method of accounting for a business combination (pooling of interests or purchase) and the amortization period of goodwill and negative goodwill, provided that the financial statements comply with IAS 22, *Business Combinations*.<sup>188</sup>

In the auditing arena, the staff closely monitored the efforts of the International Auditing Practices Committee (IAPC) of the International Federation of Accountants to codify the International Standards on Auditing (ISAs). As a result of its oversight, the staff became concerned with the introduction of black lettering, which resulted in portions of the standards that were deemed by the IAPC to represent "basic principles and essential procedures" being presented in bold type. As a result, uncertainty was introduced into the standards regarding the amount of work to be performed by an auditor in order to represent that his or her audit complied with the ISAs. The staff's concerns were communicated to IOSCO and, through IOSCO, to the IAPC. The IAPC did not address IOSCO's concerns in its final standards. As a result, IOSCO was unable to reach a consensus to endorse the codified ISAs. The staff has advised the IAPC that additional changes to the final codified standards are necessary before the staff would recommend that the Commission support an IOSCO endorsement of the ISAs.

## **Other Litigation and Legal Activities**

*The General Counsel represents the Commission in all litigation in the United States Supreme Court and the courts of appeals. The General Counsel defends the SEC and its employees when sued in district courts, prosecutes administrative disciplinary proceedings against attorneys, appears amicus curiae in significant private litigation involving the federal securities laws, and oversees the regional offices' participation in corporate reorganization cases. The General Counsel analyzes legislation that would amend the federal securities laws or other laws affecting the work of the agency, drafts congressional testimony, prepares legislative comments, and advises the Commission on issues arising from the agency's regulatory and enforcement activities including all public releases and rule proposals. In addition, the General Counsel advises the Commission in administrative proceedings under various statutes, and advises the Commission and prepares both opinions with respect to appeals from administrative law judges' decisions and self-regulatory organizations'(SRO) disciplinary actions, and orders resolving related motions.*

### **Key 1995 Results**

Issues of major importance were litigated in 1995 in cases in which the Commission participated, either as a party or as *amicus curiae*. In *Mastrobuono v. Shearson Lehman Button, Inc.*,<sup>189</sup> the United States Supreme Court held that inclusion of a New York choice of law provision in a broker-dealer's arbitration agreement with its customers does not bar arbitrators from awarding punitive damages that would otherwise have been available in a court. In *Gustafson v. Alloyd Co.*,<sup>190</sup> the United States Supreme Court held

that Section 12(2) of the Securities Act of 1933 (Securities Act) applies only to public offerings of securities by the issuer or controlling persons of the issuer. In *Plant v. Spendthrift Farm, Inc.*,<sup>191</sup> the Supreme Court held that the part of Section 27A of the Securities Exchange Act of 1934 (Exchange Act) that allowed the reinstatement of certain private actions after dismissal on statute of limitations grounds was an unconstitutional violation of the separation of powers doctrine. The Commission participated as *amicus curiae* in the foregoing cases. In *Blount v. SEC*,<sup>192</sup> the United States Court of Appeals for the District of Columbia Circuit upheld, against constitutional challenge, the Commission's approval of Municipal Securities Rulemaking Board Rule G-37, which imposes limitations on the activities of certain municipal securities dealers who contribute to issuer officials or who solicit or coordinate contributions on behalf of those officials.

The SEC continued to handle a large number and a wide variety of legislative matters in 1995. The SEC testified, and the staff provided technical and other assistance, with respect to bills addressing such subjects as revision of the private securities litigation system, Glass-Steagall repeal, regulatory reform, repeal of the Public Utility Holding Company Act of 1935 (Holding Company Act), the regulation of municipal securities, and a proposed merger of the SEC and the Commodity Futures Trading Commission (CFTC).

A record 74 new appeals were filed with the Commission in 1995. The adjudicatory staff kept pace with its 1994 output by submitting to the Commission a total of 82 draft opinions and orders resolving substantive motions.

## Significant Litigation Developments

### *Arbitration*

In *Mastrobuono v. Shearson Lehman Button, Inc.*,<sup>193</sup> the United States Supreme Court, as urged by the SEC as *amicus cunae*, held that inclusion of a New York choice of law provision in a broker-dealer's arbitration agreement with its customers does not bar arbitrators from awarding punitive damages that would otherwise have been available in a court, even though New York decisional law does not permit punitive damages to be awarded by an arbitrator.

### *Scope of Section 12(2) of the Securities Act*

In *Gustafson v. Alloyd Co.*,<sup>194</sup> the United States Supreme Court held that Section 12(2) of the Securities Act applies only to public offerings of securities by the issuer or controlling persons of the issuer. The SEC, as *amicus curiae*, had contended that Section 12(2) applies to all types of sales. Section 12(2) gives buyers a right of rescission against sellers who make false or misleading representations.

### *Statutes of Limitation*

In *Plaut v. Spendthrift Farm, Inc.*,<sup>TM5</sup> the Supreme Court held, contrary to the position urged by the SEC as *amicus curiae*, that part of Section 27A of the Exchange Act was unconstitutional on the ground that it violated the separation of powers doctrine. Section 27A, which had two parts, had been enacted to prevent retroactive application of the one-year/three-year statute of limitations the Court had adopted in *Lampf, Pleva, Lipkind, Prupisi and Petigrow v. Gilbertson*.<sup>196</sup> The part of Section 27A that the Court invalidated allowed private actions under Section 10(b) of the Exchange Act to

be reinstated even though they had been finally dismissed prior to enactment of Section 27A.

### *Regulation of Municipal Securities*

In *Blount v. SEC*,<sup>197</sup> the United States Court of Appeals for the District of Columbia Circuit upheld the validity of Municipal Securities Rulemaking Board Rule G-37, which imposes limitations on the activities of certain municipal securities dealers who contribute to issuer officials or who solicit or coordinate contributions on behalf of those officials. The court found that the Rule did not violate the First Amendment, was not impermissibly vague, and did not violate the Tenth Amendment.

In *United States v. Rudi*,<sup>198</sup> the United States District Court for the Southern District of New York, as urged by the SEC as *amicus curiae*, refused to dismiss an indictment charging the independent financial adviser to a New Jersey county with securities fraud. The court held that Rudi's failure to disclose kickbacks he allegedly received from the underwriter of the county's bonds was "in connection with" the sale of the bonds for purposes of Section 10(b) of the Exchange Act. The court also rejected Rudi's assertion that Section 10(b) does not apply to a transaction between an issuer and its underwriter.

### *Proxy Rules—Shareholder Proposals*

In *NYCERS v. SEC*,<sup>99</sup> the United States Court of Appeals for the Second Circuit reversed a district court order regarding a SEC no-action letter interpreting the "ordinary business" exception contained in the Commission's shareholder proxy proposal rule, holding, as urged by the Commission, that a no-action letter does not have the binding force of law and therefore is not a legislative rule requiring notice and comment under the Administrative Procedure Act. The

court also dismissed plaintiffs' claim against the Commission that the position taken in the no-action letter was arbitrary and capricious, holding that shareholders who disagree with that interpretation have the adequate judicial remedy of suing a company that refuses to include a shareholder proposal.

### *Violation of Anti-Fraud Provisions*

In *SEC v. Maw*,<sup>200</sup> the United States Court of Appeals for the Seventh Circuit affirmed a district court decision finding that the defendants had engaged in fraudulent insider trading. In so doing, the Court joined the United States Courts of Appeals for the Second and Tenth circuits in holding that the SEC had validly exercised its rulemaking authority in adopting Exchange Act Rule 14e-3,<sup>201</sup> which prohibits insider trading in connection with a tender offer.

In *SEC v. Lauer*,<sup>202</sup> the Court of Appeals for the Seventh Circuit held that a program falsely represented as involving the use of commingled investor funds for trading "prime bank" instruments constituted a security and was properly enjoined as involving fraud in the sale of those securities.

### *Requests for Access to Commission Records*

The Commission received approximately 100 subpoenas for documents and testimony in 1995. In some of these cases, the Commission declined to produce the requested documents or testimony because the information sought was privileged. The Commission's assertions of privilege were upheld in every instance when the party issuing the subpoena challenged the assertion in court.

The Commission received 2,389 requests under the Freedom of Information Act (FOIA) for access to agency records. There were 64

appeals to the SECs General Counsel from initial denials by the FOIA Officer. Three actions were brought in federal court challenging Commission decisions under the FOIA. One case was withdrawn by the plaintiff; the second is pending. In the third case, the requester sought review of the FOIA Officer's initial denial of a request without first appealing to the Commission. The court granted the Commission's motion for summary judgment and the requester has appealed to the United States Court of Appeals for the D.C. Circuit<sup>203</sup>

### *Motions to Vacate Permanent Injunctions*

In *SEC v. Worthen*, John Worthen moved to vacate a permanent injunction entered against him in 1974. Worthen, a twice-convicted securities law violator, argued that his injunction should be vacated primarily because it was entered upon his default. The Commission opposed Worthen's motion, arguing that Worthen's injunction was valid and noted that Worthen pled guilty to criminal contempt of the injunction in 1989. Worthen's motion was denied without opinion, Worthen's appeal is pending.<sup>204</sup>

In *SEC v. Calvo*, William Calvo moved to vacate a permanent injunction entered against him in 1988.<sup>205</sup> The injunction arose out of Calvo's participation, as underwriter's counsel, in a public offering. The court vacated the permanent injunction on the grounds that, in light of the effects of the injunction, its continuance constituted fundamental unfairness.

### *Motions for Attorneys' Fees Under the Equal Access to Justice Act*

Applications for attorneys' fees aggregating approximately \$2 million were filed by defendants in four Commission enforcement actions in which the Commission did not obtain all or certain of the relief it sought against a particular defendant. Three of those applications were denied, as the court found that the Commission

was substantially justified in bringing the action or that the defendant did not otherwise qualify for an award of fees.<sup>206</sup> In one of those cases, *SEC v. Littler*, the court denied Equal Access to Justice Act fees because even though the court declined to issue an injunction against him, Littler was found to have violated the federal securities laws and thus was not a prevailing party entitled to fees. The fourth is pending.

#### *Actions Against the Commission and the Staff'*

Numerous court actions, seeking millions of dollars in the aggregate, were brought against the Commission and its staff alleging constitutional, statutory, and common law tort violations in connection with the conduct of various enforcement investigations. All of these actions were dismissed except one, in which a summary judgment motion on behalf of the staff member is pending.<sup>207</sup>

#### *Actions Under the Right to Financial Privacy Act*

In FY1995, 30 actions were filed against the Commission in federal district court pursuant to the Right to Financial Privacy Act (RFPA). The movants in these cases sought to quash Commission subpoenas to financial institutions for the movants' bank account records. In each of the cases decided, the court denied the motion to quash and ordered the subpoena enforced, finding a demonstrable reason to believe that the subpoenaed records were relevant to a legitimate law enforcement inquiry and that the staff had complied with the procedural requirements of the RFPA. The remainder of the cases are pending or were withdrawn.

#### *Asset Freezes*

In *Colello v. SEC*, the court held that the Swiss-United States Treaty on Mutual Assistance in Criminal Matters—which enables

U.S. law enforcement agencies to freeze an individual's Swiss assets—violates the Fourth and Fifth Amendments to the United States Constitution.<sup>208</sup> In so doing, the court rejected the government's argument that the Swiss appeals process established pursuant to the Treaty provides an individual whose Swiss assets have been frozen with an adequate opportunity to challenge the basis for a freeze for purposes of the Due Process Clause. The court also rejected the government's argument that the "reasonable suspicion" standard—pursuant to which Swiss asset freezes may be executed under the Treaty—is reasonable for purposes of the Fourth Amendment.

### *Challenges to Commission Rules*

In *U.S. Securities Corporation v. SEC*, the court dismissed a petition for a writ of mandamus requiring the Commission to exempt petitioners from membership in the National Association of Securities Dealers (NASD) and from certain broker-dealer reporting and net capital requirements because petitioner was a small business. The court also dismissed the request for a declaratory judgment that Section 15(b)(8) of the Exchange Act, which requires all broker-dealers to be members of a national securities association is unconstitutional.

In *Britton v. Chalsty*, the Magistrate Judge issued a Report and Recommendation that a declaratory judgment action against the Commission be dismissed. The Magistrate Judge found, as urged by the Commission, that the district court lacked jurisdiction to consider whether Commission Rule 17a-3, which directs broker-dealers to seek arrest information from persons applying to become associated persons, violates Title VII of the Civil Rights Act of 1964. The Magistrate Judge concluded that Section 25(b)(1) of the Exchange

Act provides that United States courts of appeals have exclusive jurisdiction over challenges to Commission rules or orders.

### **Significant Adjudication Developments**

The staff submitted to the Commission 82 draft opinions and orders resolving substantive motions, consistent with 1994's record 81 draft opinions and orders. The staff resolved by delegated authority another 72 motions. The Commission issued 57 opinions and 34 related orders.

Seventy-four new appeals were filed with the Commission in 1995, exceeding the record 71 received in 1993. A higher percentage of the Commission's adjudication docket than in prior years now is represented by appeals from decisions of administrative law judges, including decisions in Commission Rule 2(e) proceedings against accountants.

#### *Joint Arrangement under the Investment Company Act of 1940*

For the first time in recent years, the Commission addressed in an adjudicatory decision the reach of Section 17(d) of the Investment Company Act of 1940 (Investment Company Act) and Rule 17d-1 thereunder. These provisions require prior Commission approval of any joint arrangement involving an investment company and an affiliated person. In *Sequoia Partners, L.P.*, the Commission declined to approve a joint arrangement between Counselors Tandem Securities Fund, Inc. (the Fund), and Sequoia Partners, L.P. (Sequoia), a partnership that had acquired over 25 percent of the Fund's common stock.<sup>209</sup> The Fund and Sequoia had executed a settlement agreement that required the Fund both to make a tender offer for its common shares at 95 percent of net asset value (NAV), and to reimburse Sequoia for \$240,000 of expenses that Sequoia incurred in a proxy contest with the Fund. The Commission rejected

the application to approve the reimbursement as untimely, as the Fund already had placed the \$240,000 at issue in escrow. The Commission further concluded that Sequoia's effort to obtain reimbursement constituted overreaching by an affiliate, which is inconsistent with the Act's objective to prevent such self-dealing. Lastly, the Commission found that the proposed arrangement violated the "best price" requirement (Exchange Act Rule 13e-4(f)(8)(ii)) of the Commission's tender offer rules, because Sequoia thereby was to be paid almost 100 percent of NAV on tender of its shares while other shareholders were to be paid 95 percent of NAV on their tenders.

#### *Acquisition Approved under the Holding Company Act*

In its only Holding Company Act decision this year, the Commission granted two applications under that Act filed by Gaz Metropolitan, Inc. (GMLI) and Gaz Metropolitan and Company, Limited Partnership (GMLP), Canadian public companies.<sup>210</sup> Applicants sought, among other things, permission for GMLP to complete its acquisition of the stock of Northern New England Gas Corporation (NNEG), a Vermont exempt holding company that owns all the stock of Vermont Gas Systems, Inc. (VGS), a Vermont corporation that provides gas service in that state. In approving the acquisition under Section 10(c)(2) of the Holding Company Act, the Commission concluded that nothing in the Holding Company Act prevents a foreign company that does not own or control public utility or holding company securities from acquiring the securities of a domestic public utility company.

#### *Sales Practice Abuses/Deficient Supervision*

Again this year the Commission reviewed a number of cases finding sales practices abuses and deficient supervision. In *Dan A. Druz*,<sup>211</sup> for example, the Commission found a branch manager of

Shearson Lehman Brothers, Inc. to have failed reasonably to supervise and control the activities of a salesman who executed over 100 unauthorized trades in the accounts of three different customers,

In *Patricia A. Johnson*,<sup>212</sup> the Commission found that a former branch manager of Paine Webber, Inc. failed to provide effective and reasonable supervision of a registered representative with a view towards preventing that person's violations of the antifraud provisions. Johnson disregarded firm procedures and ignored numerous "red flags" including several customers' complaints about the handling of their accounts, which included charges of misuse of customer funds. The Commission found that the limited action Johnson took against the representative—placing him on probation—was insufficient. Johnson also had contended on appeal that this administrative proceeding was brought in violation of the federal statute of limitations contained in 28 U.S.C. § 2462. The Commission concluded that Section 2462 does not apply to proceedings brought under Section 15(b) of the Exchange Act that seek only remedial sanctions.

In another appeal of a law judge's decision, *Martin Merer Engelman, Peter Paul Kirn, and Lawrence David Isen*,<sup>213</sup> the Commission found that a Stuart-James, Inc. branch manager and his two assistants engaged in pervasive fraud in their dealings with customers. Their misconduct included inducing customers to buy speculative securities with promises that these investments were safe and would result in tremendous gains within short periods of time/ and withholding from customers information that investors in the recommended securities stood to lose their entire investment. The Commission barred all three respondents from association with any broker or dealer and entered cease and desist orders in this matter.

### *Unfair Commissions/Excessive and Fraudulent Markups*

In *Atlanta-One, Inc., et al.*,<sup>214</sup> the Commission agreed with the NASD that commissions representing between 14 and 89 percent of customers' investments in foreign currency options traded by the firm were unfair. The Commission found that general proscriptions against gouging customers placed the respondents on notice that charging commissions at these rates was conduct inconsistent with just and equitable principles of trade. The Commission accordingly sustained the censures, 30-day suspensions, fines, and requalification requirements the NASD had imposed for this misconduct.

Finally, in one of a number of disciplinary actions concerning retail markups on securities reviewed this year, *Hibbard, Brown & Co. et al.*,<sup>215</sup> the Commission found that an NASD member firm and its president and head trader charged customers excessive and fraudulent markups in thousands of sales of a common stock, generating over \$8.7 million in excessive profits in only eight trading days. The Commission concluded that these respondents violated a dealer's fundamental duty to treat its customers fairly when they arranged to acquire the stock at less than half the price that they were selling it to their retail customers. Concluding too that the inter-dealer market for the stock was the result of a "stage-managed performance" which produced wholly illusory prices, the Commission rejected the respondents' contention that the best evidence of the fairness of their retail prices was the numerous inter-dealer transactions in the stock. The Commission instead found that/ because the firm was not a market-maker in the stock, the firm's contemporaneous cost of acquiring the stock provided the best evidence of prevailing market price. The Commission sustained the NASD's censures and fines of the three respondents and its

determination to expel the firm from NASD membership and bar both the president and head trader from association with any member.

### **Significant Legislative Developments**

Congress actively considered, but did not enact, a number of bills that would affect the work of the SEC. Most notably, (1) the House and Senate passed separate litigation reform measures; (2) a House bill was introduced to revise the federal securities laws and "deregulate" the United States capital markets; (3) a House bill was introduced to amend or supplement provisions of the Investment Company Act; (4) following extensive hearings, both the House Banking and the House Commerce Committees approved legislation to repeal the Glass-Steagall Act; (5) the House held hearings on proposals to repeal the Public Utility Holding Company Act; (6) a Senate bill was introduced to delegate to the states the regulation of smaller investment advisers; (7) a bill was introduced and hearings held in the House regarding the merger of the SEC and the CFTC; (8) bills were introduced in the House and Senate regarding the exemption from the securities laws of charitable organizations that issue charitable gift annuities; and (9) three bills were introduced in the House and one in the Senate addressing the regulation of participants in the derivatives markets, and oversight hearings were held to explore the issue of Orange County, California's derivatives-related losses. Legislative activity in most or all of these areas is expected to continue in 1996.

#### *Securities Litigation Reform*

House and Senate bills providing for the reform of the private securities litigation system were introduced in the opening days of the 104th Congress. Both H.R. 1058 (passed by the House in March 1995) and S. 240 (passed by the Senate in June 1995) contain provisions that would, among other things: eliminate certain abuses

associated with class action lawsuits; eliminate civil racketeer influenced and corrupt organizations liability for securities law violations; replace joint and several liability with proportionate liability for defendants who act recklessly; and provide for an express right of contribution among co-defendants. Differences between the two bills exist with respect to such highly controversial issues as: the creation of statutory safe harbors for forward-looking statements; the codification of a definition of "recklessness;" pleading standards for fraud actions; and the availability of the fraud-on-the-market theory of liability. As of September 30, 1995, conferees had yet to be named to resolve the differences between the House and Senate bills.

In testimony earlier in the year before House and Senate committees on the respective bills, the SEC expressed support for efforts to make private securities litigation more effective and to deter meritless lawsuits. At the same time, the SEC opposed provisions that would (among other things) eliminate recklessness as a basis for liability, establish a broadly applied scheme of proportionate liability, and create an overly broad safe harbor for forward-looking statements.

### *Glass-Steagall Repeal*

Two major Glass-Steagall reform proposals were introduced early in the 104th Congress. The House Banking and Commerce Committees both held hearings on and reported legislation (H.R. 1062) that would have, among other things, (1) permitted banks to affiliate with securities firms through a holding company structure, and (2) taken some steps to bring certain bank securities activities within the federal securities regulatory scheme, but (3) nonetheless allowed banks to conduct a range of broker-dealer activities directly or through "separately identifiable departments or divisions" of the bank. The SEC testified before both Committees, reaffirming its long

tradition of support for financial services modernization in the context of functional regulation.

As of September 30, 1995, H.R. 1062 had apparently been linked with another bill (H.R. 1858) that contained a variety of regulatory relief provisions and highly controversial provisions relating to bank insurance powers. It was unclear whether disagreements over the issue of bank insurance powers would prevent Glass-Steagall legislation from moving forward in fiscal 1996. For its part, the Senate did not actively take up the issue of Glass-Steagall reform in 1995, though early in the year Senator D'Amato introduced a bill to significantly broaden the scope of commercial as well as securities activities permitted for companies that own banks.

### *Securities Deregulation*

H.R. 2131, the "Capital Markets Deregulation and Liberalization Act of 1995," was introduced in the House in July 1995. The bill, which seeks to reduce regulatory overlap and lower the costs of raising capital, would, among other things: preempt most state securities regulation; redefine the suitability obligations of broker-dealers with respect to "institutional investors;" repeal much of the Williams Act (the statute regulating tender offers); relax prospectus delivery requirements under the Securities Act; grant the SEC general and specific exemptive authority under the Securities Act; repeal the Trust Indenture Act of 1939; and reduce the number of SEC Commissioners from five to three. No action had been taken on H.R. 2131 as of September 30, 1995; however, hearings on the measure were scheduled for November 1995.

### *Investment Adviser Regulation*

The opening days of the 104th Congress saw the introduction of S. 148, the "Investment Advisers Integrity Act," in the Senate. S. 148

would target specific amounts from the SEC's budget that would have to be devoted to enforcement of the Advisers Act. The bill also would reallocate responsibility for regulation of investment advisers between the federal and state securities regulators; it would essentially exempt from registration with the SEC (and make the states responsible for regulating) investment advisers that manage less than \$5 million in assets. Under the bill, the SEC would retain authority to investigate allegations of fraud involving any investment adviser, whether registered with the SEC or with a state regulator. The SEC also would have discretionary rulemaking authority to require SEC registration of investment advisers that manage between \$1 million and \$5 million in assets. The Senate, however, took no action on S. 148 in 1995, and no comparable legislation was introduced in the House.

#### *Investment Company Act Amendments*

H.R. 1495, the "Investment Company Act Amendments of 1995" was introduced in April 1995. Incorporating a number of recommendations from a 1992 SEC staff report, the bill seeks to modernize aspects of investment company operation and regulation. H.R. 1495 would, among other things: except from regulation under the Investment Company Act investment pools that include only highly sophisticated purchasers, and streamline the existing exception for "private" investment companies; require a majority of fund directors to be independent; reduce the number of shares necessary for approving certain important matters, such as advisory contracts and changes in a fund's investment objective; give funds greater advertising flexibility; authorize the creation of a mutual fund with a single unified fee covering all fund services and most expenses; and lift restrictions on mutual funds making investments in other mutual funds in the same fund complex. No counterpart to H.R. 1495 was introduced in the Senate in 1995, and the House took no

action on the bill prior to September 30, 1995; however, hearings were held in the House early in fiscal 1996.

### *Regulation of Public Utility Holding Companies*

In June 1995, the SEC issued a staff report discussing the results of a one-year study of the Holding Company Act. The report contained three alternative legislative recommendations: (1) repeal of the Holding Company Act, accompanied by additional authority at the state and federal level for the continued protection of consumers; (2) outright repeal of the Act; or (3) full exemptive authority under the Act for the SEC. In testimony before subcommittees of the House Commerce Committee, the SEC expressed its preference for the first alternative—conditional repeal. Legislation embodying this recommendation was subsequently introduced in October 1995.

Separately, the Senate in 1995 considered and passed a telecommunications bill (S. 652), one small part of which would broaden the ability of registered public utility holding companies to diversify into telecommunications and information services, notwithstanding the prohibitions on diversification imposed by the Holding Company Act. House-passed telecommunications legislation (H.R. 1555), however, would not affect the ability of registered holding companies to engage in telecommunications or information services under the Holding Company Act.

### *SEC-CFTC Merger*

H.R. 718, the "Markets and Trading Reorganization and Reform Act," was introduced in January 1995 and was referred primarily to the House Banking Committee. The bill proposes to replace the SEC and the CFTC with a new, merged Markets and Trading Commission. The SEC testified before a subcommittee of the House Banking Committee regarding H.R. 718 in March 1995. The SEC

testified that, while a merger of the two agencies might make sense in a number of ways, the benefits of such a merger do not at this point justify the time and political capital that would be needed to accomplish it. In addition, the SEC expressed concern about specific provisions of the bill, which could make the transition to unified regulation very cumbersome. As of September 30, 1995, H.R. 718 had not been reported out of the Banking Committee.

### *Regulatory Reform*

The 104th Congress considered numerous regulatory reform bills in 1995. In general, the bills considered would alter the way that all federal agencies, including the SEC, write and review rules. In a number of instances, the SEC testified and/or provided written statements describing the likely impact of specific bills on the agency's independence and its enforcement program.

In March 1995, the House passed H.R. 9 that would, among other things: compensate private property owners for certain regulatory restrictions that limit the use of their property; give the Office of Management and Budget an enhanced role in analyzing agency rulemakings under the Regulatory Flexibility Act; and require agencies to analyze benefits and costs in connection with their risk-assessment activities. (Paperwork reduction provisions, originally part of H.R. 9, were passed as a separate measure by both the House and Senate and signed into law as Pub. L. No. 104-13 in May 1995).

### *SEC 1996 Funding*

The solution to the offsetting fee problem of the SEC's 1995 appropriation was understood to be a one-time, stopgap measure. Work on the SEC's 1996 appropriation, therefore, required agreement on a long-term approach to funding the agency. In June

1995, House Commerce Committee Chairman Bliley announced an agreement in principle with the chairmen of the Appropriations and Ways and Means Committees on a long-term funding mechanism for the SEC. Under the agreement, securities registration fees would be gradually reduced, while funding from the United States Treasury general appropriation account for the agency would increase.

The House in July 1995 passed an appropriations bill (H.R. 2076) that generally reflected this agreement: it would provide the SEC with funding for 1996 at the \$297 million level that was in place for 1995 (and a securities registration fee rate of 1/29th of one percent in Section 6(b) of the Securities Act). The Senate Appropriations Committee, by contrast, in September 1995 approved a bill that would have cut the SEC's funding for 1996 by 20 percent from the 1995 level. The Senate subsequently passed legislation that would cut the SEC's appropriation by 10 percent. At the end of fiscal 1995, the SEC's funding still was uncertain, as was the funding for virtually all other federal agencies.

### *Other Legislation and Hearings*

Bills also were introduced in the House and Senate in 1995 addressing, among other things, the regulation of participants in the derivatives markets and the disclosure obligations of issuers of municipal securities.

### **Corporate Reorganizations**

The Commission, as a statutory adviser in reorganization cases under Chapter 11 of the Bankruptcy Code, seeks to assure that the interests of public investors are adequately protected. During 1995, there were 120 active Chapter 11 cases involving public companies. The Commission entered a formal appearance in 13 cases with significant public investor interest. The Commission also was actively

involved during 1995 as a statutory party in the *Orange County*<sup>216</sup> bankruptcy/ the largest municipal bankruptcy ever filed under Chapter 9 of the Bankruptcy Code, in order to protect the holders of the County's public debt securities and the municipal bond market generally. The Commission sought in addition to prevent any disruption of trading in the wake of the bankruptcy filing.

### *Committees*

Official committees negotiate with debtors on the formulation of reorganization plans and participate generally in all aspects of the case. The Bankruptcy Code provides for the appointment of an official committee for stockholders where necessary to assure adequate representation of their interests.

During 1995, the Commission sought to assure that committees were not hindered in their efforts to represent public investors, successfully objecting to attempts to dissolve the committee in *In re Amenca West Airlines*,<sup>217</sup> and to limit the scope of the committee's activities in *In re UDC Homes*.<sup>218</sup> The Commission also reiterated its position that insider trading prohibitions apply to members of official committees, who frequently receive confidential information on a company's operations and prospects. In *In re County of Orange*,<sup>219</sup> *In re House of Fabrics, Inc.*,<sup>220</sup> and *In re Baldwin Builders*,<sup>221</sup> the Commission supported the adoption of court orders permitting trading in the debtor's securities only by committee members that engage in securities trading in the regular course of their business and that implement procedures designed to prevent the misuse of inside information.

### *Disclosure Statements/Reorganization Plans*

A disclosure statement is a combination proxy and offering statement used to solicit acceptances for a reorganization plan. Such

plans often provide for the issuance of large quantities of new unregistered securities pursuant to an exemption from Securities Act registration contained in the Bankruptcy Code. During 1995, the staff reviewed 92 plans and disclosure statements and commented on 75. Recurring problems with disclosure statements included inadequate financial information, lack of disclosure on the issuance of unregistered securities and insider transactions, and plan provisions that contravene the Bankruptcy Code. Most of the staff's comments were adopted by the debtors without the need for formal Commission intervention.

In *In re Trans World Airlines*,<sup>222</sup> *In re Diversified, Inc.*<sup>223</sup> and *In re Phar-Mor, Inc.*<sup>224</sup> the Commission objected to plan provisions that would have discharged third parties, such as officers and directors, from liabilities. This issue is of significance to investors because in many cases debtors seek to use the Chapter 11 process to protect officers and directors from personal liability for various kinds of claims, including liability under the federal securities laws.

### *Enforcement Matters*

Bankruptcy issues frequently arise in Commission enforcement actions. In *In re Bilzerian*,<sup>225</sup> a case with significant implications for the enforcement program, the district court overruled a bankruptcy court order that had barred the Commission from bringing an action to have its \$33 million securities fraud disgorgement judgment excepted from discharge in Bilzerian's bankruptcy proceeding. In *In re Steven Weil*,<sup>226</sup> the Commission blocked an attempt by a debtor to use the automatic stay of the Bankruptcy Code to prevent enforcement of a disgorgement order entered in a Commission law enforcement action.

## **Ethical Conduct Program**

In 1995, the Ethics Office staff continued to respond to a demand for counseling services at the rate of approximately 20 new matters per week. These inquiries reflected unique or novel issues, while routine or repetitive inquiries were handled by ethics liaison officers and deputies located within each division and office.

## **Municipal Securities Initiatives**

*The Office of Municipal Securities (OMS) was established in 1995 as part of the Commission's overall effort to provide a core of expertise and coordination on urgent and ongoing municipal securities issues, OMS provides expertise to the Commission and staff members, assists on municipal securities enforcement cases, coordinates disclosure rules and other ongoing municipal regulatory initiatives, and addresses new issues that arise in the municipal securities area. In addition, OMS provides assistance in legislative matters and works directly with issuers, investors, brokers, dealers, municipal securities dealers, and other professionals on issues relating to municipal securities.*

### **Key 1995 Results**

The staff, together with the Office of the General Counsel, coordinated the SEC's participation in the Orange County, California municipal bankruptcy and related issues. The staff also worked with the Division of Enforcement, both in Washington and in the regional and district offices, providing technical assistance in the many municipal securities investigations and enforcement proceedings undertaken since the beginning of 1995. In addition, along with the Divisions of Market Regulation and Corporation Finance, the staff provided guidance to the municipal markets including issuer, broker, dealer, and municipal securities dealer organizations, in conjunction with the implementation of amendments to Rule 15c2-12 of the Securities Exchange Act of 1934, as amended (Rule 15c2-12) concerning secondary market disclosure.

The staff appeared on behalf of the SEC before the House Subcommittee on Capital Markets, Securities and Government Sponsored Enterprises of the House Banking Committee and testified on the municipal securities markets in the aftermath of the Orange County, California bankruptcy.

### **Municipal Securities Disclosure**

The staff planned and organized the Commission's participation in a teleconference on municipal securities disclosure sponsored by the Government Finance Officers Association (GFOA), the National Association of Counties, and the Public Securities Association (PSA). Chairman Arthur Levitt and SEC staff participated in the teleconference and provided general information and direction on municipal securities disclosure and the prudent management of public funds. Specific information also was provided on Rule 15c2-12. The teleconference provided information and responses to queries from municipal securities professionals, including issuers. Approximately 1,200 individuals participated in the live broadcast of the teleconference.

The staff worked to educate municipal market participants in the implementation of, and compliance with, amendments to Rule 15c2-12, which require secondary market disclosure. The staff also provided guidance to market participants regarding recent SEC enforcement decisions that apply the antifraud provisions of the federal securities laws to the municipal securities markets and professionals. In furtherance of this effort, the staff met with numerous organizations involved in the municipal finance industry.

### **Technical Assistance**

In 1995, the staff provided support to Chairman Levitt's and Secretary of the Treasury Rubin's joint efforts to increase the

awareness of local government financial officers of the need for the prudent management of public funds in today's markets. The staff, working through the Office of Legislative Affairs, also provided technical assistance to Congress on issues involving municipal securities, such as providing information on the investment of public funds, suitability requirements, and the municipal bankruptcy in Orange County, California.

The staff worked with the Division of Market Regulation on matters relating to the Municipal Securities Rulemaking Board (MSRB), including the implementation of MSRB rule G-37, which prohibits brokers, dealers, and municipal securities dealers from engaging in municipal securities business with issuers if certain political contributions have been made to officials of such issuers. In addition, the staff worked with the Divisions of Market Regulation and Corporation Finance on various issues surrounding the implementation of amendments to Rule 15c2-12.

The staff worked with the Office of the General Counsel on the municipal bankruptcy in Orange County, California, and other municipal securities matters; assisted the Office of Compliance Inspections and Examinations in oversight concerning municipal securities regulations; provided technical assistance to the Division of Investment Management on proposed rulemaking; and assisted the Office of Investor Education and Assistance on issues pertaining to individual investors and municipal securities price transparency.

OMS staff provided technical assistance to the Division of Enforcement on several municipal securities enforcement actions, including: *SEC v. Stifel, Nicolaus and Company, Inc.*, Litigation Release No. 14587 (August 3, 1995), 59 SEC Docket 2964; *SEC v. Goodman and Harold Tzinberg*, Litigation Release No. 14471 (April 18, 1995), 59 SEC Docket 0457; *SEC v. Terry D. Busbee and*

*Preston C. Bynum*, Litigation Release No. 14387 (January 23, 1995), 58 SEC Docket 1949; and *SEC v. Nicholas A. Rudi, Joseph C. Salerna, Public Capital Advisors, Inc. formerly known as Consolidated financial Management, Inc, George L. Tuttle, Jr. and Alexander S. Williams*, Litigation Release No. 14421 (February 23, 1995), 58 Docket 2495.

## **Economic Research and Analysis**

*The Office of Economic Analysis (OEA) provides the Commission and the operating divisions with the technical and analytical support necessary to understand and evaluate the economic effects of Commission regulatory policy. OEA plays a major role in the Commission's enforcement effort by applying economic and statistical tools to issues such as materiality and disgorgement.*

### **Key 1995 Results**

In 1995, the staff focused its efforts on a number of areas, including enforcement cases, mutual fund disclosure, and market structure issues. The staff provided technical assistance to the Division of Enforcement, designed a survey to evaluate investors' understanding of financial products, and analyzed various risk measures in connection with the Commission's release on mutual fund risk disclosure.

### **Economic Analysis and Technical Assistance**

The staff assisted the Division of Enforcement in approximately 40 cases of insider trading, market manipulation, fraudulent financial reporting, and other violations of securities laws. This work generally involved the application of financial economics and statistical techniques to determine whether the elements of fraud are present and to estimate, where appropriate, the amount of disgorgement to be sought. In particular, the staff assisted in the development of data presented at trial in the action against First Jersey Securities, assisted in the taking of testimony in cases involving complex financial instruments, and assisted in evaluating reports of consultants and the testimony of experts hired by opposing parties.

The staff also assisted the Division of Enforcement in several large-scale investigations.

The staff developed a survey, in cooperation with the Division of Investment Management (IM), aimed at learning what individual investors understand about financial products. Responses to a nationwide telephone survey of mutual fund owners were used to examine why investors choose particular mutual funds. The statistical analysis focused on relations between the type of fund and venue, purchase information, investment knowledge possessed by investors, and various demographic variables. This survey led to a Profile Prospectus focus-group program, which is currently being conducted by IM and several mutual fund families. The staff also provided an extensive statistical analysis of risk measures in support of IM's concept release on mutual fund risk disclosure.

The staff provided extensive statistical analysis for the Commission's Advisory Committee on Capital Formation and Regulatory Processes, which is considering company registration versus the registration of individual securities offerings. This analysis addressed the costs of new issues and the volume of offerings, the effects of various possible thresholds for issuer participation in company registration, and the impact of SEC review of prospectuses.

The staff provided advice and a variety of statistical analyses, related to market structure issues, to the Commission and operating divisions. These included analyses of the impact of small order execution system trading activity on the NASDAQ market. New York Stock Exchange specialists' profitability and market participation, the effects of preferenced order flow and related pilot programs, execution quality, market fragmentation, and payment for order flow.

The staff continued to monitor the securities industry and developments in the domestic and international securities markets. In

addition, the staff analyzed 90 rule proposals to assess their potential effects on small entities as required in the Regulatory Flexibility Act of 1980.

During the year, OEA initiated a variety of projects designed to expand the Commission's understanding of the capital markets. These projects are long-term in nature and focus on the use and economics of soft dollar commissions, price stabilization in the initial public offering aftermarket, the demand for proprietary trading systems, and the trading of American Depository Receipts and foreign securities in the over-the-counter market.

## **Policy Management and Administrative Support**

*Policy management and administrative support provide the Commission and operating divisions with the necessary services to accomplish the agency's mission. Policy management is provided by the executive staff, including the Office of Legislative Affairs; the Office of the Secretary; the Office of Public Affairs, Policy Evaluation and Research; the Office of the Executive Director; and the Office of Equal Employment Opportunity. The responsibilities and activities of policy management include developing and executing management policies, formulating and communicating program policy, overseeing the allocation and expenditure of agency funds, maintaining liaison with the Congress, disseminating information to the press, and facilitating Commission meetings.*

*Administrative support includes services such as accounting, financial management, fee collection, information technology management, data processing, space and facilities management, and human resources management. Under the direction of the Office of the Executive Director, these support services are provided by the Offices of the Comptroller, Information Technology, Administrative and Personnel Management, and Filings and Information Services.*

### **Key 1995 Results**

In 1995, the Commission held 55 meetings and considered 240 matters. Major activities of the Commission included amendments to streamline financial disclosure requirements for foreign and domestic issuers, public hearings on the safe harbors from liability for disclosure of "forward looking" information, rules to streamline prospectus delivery requirements to accommodate timing concerns raised by implementation of the trade date plus three days settlement standard (known as T+3), the establishment of a program of joint and

coordinated examinations of broker-dealers and investment company activities, and rules to implement the EDGAR system.

The agency collected fees for the United States Treasury in excess of its appropriation for the thirteenth consecutive year. The SEC's total fee collections in 1995 were \$559 million and the net gain to the Treasury was \$292 million.

## **Policy Management**

*Commission Activities.* During 55 Commission meetings held in 1995, the Commission considered 240 matters, including the proposal and adoption of Commission rules, enforcement actions, and other items that affect the stability of the nation's capital markets and the economy. The Commission also acted on 1,027 staff recommendations by seriatim vote. Significant regulatory actions taken by the Commission included;

- proposing amendments to the National Market System rules on execution of customer orders by brokerage firms;
- adopting comprehensive revisions to its rules of practice for administrative proceedings;
- conducting hearings in Washington D.C, and San Francisco, California on possibly amending current rules on safe harbors for corporate disclosure;
- proposing amendments to rules on codes of ethics for investment company personnel; and
- issuing a concept release on improving disclosure of risks by mutual funds and other investment companies.

Congressional interest in the agency's activities and initiatives remained high. The Commission and staff members testified at 16 congressional hearings during the year. In addition, the Congress actively considered a number of important issues under the Commission's jurisdiction. These were most notably:

- securities litigation reform;
- concerns relative to the municipal bond and government securities markets;
- proposals for regulatory reform;
- Glass-Steagall reform and financial services modernization;
- proposals to merge the SEC and the Commodity Futures Trading Commission;
- the regulation of public utility holding companies; and
- the SEC's appropriation.

*Public Affairs.* The Office of Public Affairs, Policy Evaluation and Research (OPAPER) communicated information on Commission activities to those interested in or affected by Commission actions, including the press, regulated entities, the general public, and SEC employees through ongoing programs and special projects. The office published the *SEC News Digest* daily, which provided information on rule changes, enforcement actions against individuals or corporate entities, administrative actions, litigation releases, acquisition reports, decisions on requests for exemptions, upcoming Commission meetings, and other events of interest. OPAPER published a regular newsletter, *The SEC Employee News*, and prepared a daily summary of news clips for agency employees.

Special projects, such as support for activities related to the Chairman's investor education initiatives, the creation of the SEC's Internet Web site, and the agency's International Institute for Securities Markets Development were undertaken.

Many of the agency's actions are of national and international interest. When appropriate, these actions are brought to the attention of regional, national, and international press. The office issued 262 press releases on upcoming events, SEC programs, enforcement actions, and special projects.

In addition, the office responded to approximately 50,000 requests for specific information on the SEC or its activities. The office also coordinated visits of domestic and foreign officials to the SEC. In total, programs for 776 foreign visitors and 103 United States visitors were coordinated during the year.

*Management Activities.* The Office of the Executive Director continued to promote management controls and financial integrity and to manage audit follow-up requirements. The office continued to analyze the efficiency and effectiveness of operating divisions and support offices and to coordinate and implement the agency's compliance with and response to actions under the National Performance Review (NPR) and the Government Performance and Results Act of 1993, including development of the agency's strategic plan. Working closely with other senior officials, the staff formulated the agency's budget submissions to the Office of Management and Budget and the Congress.

*Equal Employment Opportunity.* The Office of Equal Employment Opportunity (EEO) provided the agency with support for compliance with Title VII of the Civil Rights Act of 1964, as amended; the Age Discrimination in Employment Act of 1967; the Rehabilitation Act of 1973; and the Equal Pay Act of 1963. This support was

provided through the office's compliance and affirmative employment activities.

The primary services provided by the compliance branch included counseling and dispute resolution, administrative fact-finding investigations, and final agency decisions on formal complaints of employment discrimination. In connection with the affirmative employment activity, the office participated in orientation programs for new employees and administered the Federal Women's Program, the Hispanic Employment Program, and the Black Employment Program and sponsored, along with the Office of Administrative and Personnel Management (OAPM), the SEC's Disability Issues Advisory Committee.

*Freedom of Information Act and Privacy Act.* The Office of Freedom of Information Act (FOIA) and Privacy Act Operations responded to requests for access to information pursuant to FOIA, the Privacy Act, and the Government in the Sunshine Act, and processed requests under the agency's confidential treatment rules. Confidential treatment requests were generally made in connection with proprietary corporate information and evaluated in conjunction with access requests to prevent the unwarranted disclosure of information exempt under the FOIA.

The agency received 2,430 FOIA requests and appeals, 12 Privacy Act requests and appeals, 42 Government in the Sunshine Act requests, 11 government referrals, and 8,300 requests and appeals for confidential treatment. All responses to FOIA, Privacy Act, and Government in the Sunshine Act requests were made within the statutory time-frame.

## **Administrative Support**

*Financial Management and Operations.* In 1995, the SEC collected fees in excess of its appropriation. The SEC's total fee collections in 1995 were \$559 million, 188 percent of the agency's appropriated spending authority of \$297 million (which consisted of \$75 million in appropriated funds, an appropriation of \$192 million subject to reduction as offsetting fees were received, and \$30 million from a carry-over of prior year offsetting fee collections). The \$559 million in total fee collections, minus the SEC's current year spending authority of \$267 million (\$297 million less the \$30 million from prior year offsetting fee collections), resulted in a net gain of \$292 million to the United States Treasury.

The SEC's total fee revenue in 1995 was collected from four basic sources: registrations of securities under Section 6(b) of the Securities Act of 1933 (comprising 71 percent of total fee collections), transactions of covered exchange listed securities (19 percent), tender offer and merger filings (7 percent), and miscellaneous filings (3 percent). Offsetting fee collections were generated from an increase in the fee rate under Section 6 (b) of the Securities Act from one-fiftieth of one percent to one-twenty-ninth of one percent.

During the year, the staff updated the agency's Five-Year Financial Management Plan. This plan responds to current financial system issues, recognizes new legislative and NPR requirements, and is consistent with the agency's information technology plan.

In other financial areas, the staff implemented a new Electronic Time and Attendance System, completed the testing of an off-the-shelf travel management software package, and replaced an imprest fund based travel advance program with an automated teller machine based system that uses the government credit card for travel advances.

*Information Resources Management.* The Office of Information Technology (OIT) continued to develop and enhance SEC information resources. Notably, full implementation of the Electronic Data Gathering, Analysis, and Retrieval (EDGAR) project continued to proceed smoothly. As of September 30, 1995, nearly 75 percent of all SEC registrants were filing all of their required material electronically. The last two groups of filers will enter the system in November 1995 and May 1996.

A conference was held on August 14, 1995 to solicit public input on how to improve and update the EDGAR system. In a further effort to solicit input from the public and the securities industry, the SEC published a Request for Information (RFI) in the *Commerce Business Daily* during the week of October 9, 1995. Questions included in this RFI were drawn from comments received at the August 14 conference.

The OIT continued implementing the agency's strategic automation modernization initiative. Several infrastructure improvements were implemented, including the upgrade of staff workstations and the enhancement of the local area network/wide area network. Upgraded personnel, payroll, and financial management systems were among the new systems implemented to enhance administrative functions.

Modifications to the agency's disaster recovery plans were initiated to provide the agency with fully integrated backup capabilities for its local area network and its mainframe computing resources, in the event of a disaster at either of its computer facilities—the main Operations Center in Alexandria, Virginia or the Headquarters building in Washington, D.C. Work also continued on the development of a backup capability for the EDGAR system.

On September 28, 1995, the Commission's new World Wide Web (WWW) site was inaugurated. The WWW server was configured to provide basic access to the EDGAR database of electronic filings on a 24-hour delayed basis and to provide a forum for litigation releases, news digests, press releases, Commission rulemaking activities, and a wide range of other information of interest to the investing public. Key financial information that previously was not easily accessible is now available worldwide to students, public interest groups, individual investors, and any other interested party with access to a computer and Internet interface.

*Administrative and Personnel Management.* The OAPM provided a wide range of personnel and office support functions to the agency's divisions and offices. Personnel programs included recruitment and staffing, position management and classification, employee compensation and benefits, training, performance management, employee recognition, employee relations, counseling, disciplinary actions, personnel security and suitability, personnel action processing, and maintenance of official employee records. Support programs included procurement and contracting, space acquisition, lease administration, facilities management, property management, desktop publishing, printing, publications, mail services, and telecommunications management

Efforts to streamline and reinvent personnel programs continued as a result of the NPR. Based on focus group recommendations, new policies on alternate work schedules and flexiplace were implemented in January 1995 to assist employees in balancing work and family demands. The streamlining of internal operations continued with the implementation of the first phase of the new automated Personnel Resource System and the establishment of a centralized photocopy center.

The SEC joined a consortium of federal agencies in sponsoring and participating in an in-depth study by the National Academy of Public Administration (NAPA). The purpose of the NAPA study is to discover and evaluate organizations with innovative personnel programs and to generate models for implementing change in human resources management that can be shared with government agencies.

The SEC obtained authority from the Office of Personnel Management to offer early retirements and implemented a Voluntary Early Retirement program for members of the Senior Executive Service and employees in grade 15 positions. As part of this effort, several special retirement planning seminars were provided to eligible staff.

During 1995, overall training activities increased with mandatory HIV/AIDS training for all employees, customer service training for all support office employees, and conflict resolution techniques for managers and supervisors. A total of 2,597 employees attended 5,390 training events.

The agency awarded contracts, purchase orders, and credit card purchases totalling approximately \$31,293,747 during 1995. As part of its effort to encourage the use of the government-wide credit card for purchases of commercially available goods and services under \$2,500, OAPM issued 25 credit cards to purchasing agents and contracting officers throughout the agency. The SEC administered 15 leases for an approximate total of 794,797 square feet of office and related space.

*Public Reference* The SEC maintains public reference rooms in its Washington, D.C., New York, and Chicago offices. In a continuing interest to better serve the public, the procedures in the headquarters public reference room were enhanced to expedite identification,

location, and retrieval of documents and microfiche. The public reference rooms made all company filings and Commission rules, orders, studies, reports, and speeches available to the public.

During 1995, the staff provided assistance to 28,070 visitors to the headquarters public reference room, responded to 7,070 requests for documents, processed 590 requests for certifications of filings and records, and responded to 81,350 telephone inquiries. The public reference staff received and filed 390,450 paper documents and 488,180 microfiche records to the existing library of publicly available information.

## Endnotes

<sup>1</sup> *SEC v. Block*, Exchange Act Release No. 14598 (Aug. 10, 1995), 59 SEC Docket 3112.

<sup>2</sup> *SEC v. Odulo*, Exchange Act Release No. 14591 (Aug. 7, 1995), 59 SEC Docket 3105.

<sup>3</sup> *SEC v. Pleasure Time Inc.*, Litigation Release No. 14440 (Mar. 15, 1995), 58 SEC Docket 2909.

<sup>4</sup> *SEC v. Gallard*, Litigation Release No. 14485 (May 2, 1995), 59 SEC Docket 691.

<sup>5</sup> *SEC v. Norton*, Litigation Release No. 14529 (June 14, 1995), 59 SEC Docket 1747.

<sup>6</sup> *SEC v. United Communications, Ltd.*, Litigation Release No. 14424 (Feb. 27, 1995), 58 SEC Docket 2595.

<sup>7</sup> *SEC v. Future Vision Direct Marketing, Inc.*, Litigation Release No. 14287 (Oct. 4, 1994), 57 SEC Docket 2278.

<sup>8</sup> *SEC v. Telecom Marketing, Inc.*, Litigation Release No. 14494 (Mar. 29, 1995), 58 SEC Docket 3106.

<sup>9</sup> *SEC v. Qualified Pensions, Inc.*, Litigation Release No. 14636 (Sept 13, 1995), 60 SEC Docket 708.

<sup>10</sup> *SEC v. Bloch*, Litigation Release No. 14511 (May 25, 1995), 59 SEC Docket 1271.

<sup>11</sup> *SEC v. Bennett*, Litigation Release No. 14503 (May 18, 1995), 59 SEC Docket 1147.

<sup>12</sup>*SEC v. International Breeders, Inc.*, Litigation Release No. 14607 (Aug. 17, 1995), 59 SEC Docket 3228.

<sup>13</sup>*SEC v. Naiman*, Litigation Release No. 14463 (Apr. 10, 1995), 59 SEC 260.

<sup>14</sup>*SEC v. First Capital Holdings Corp., Inc.*, Litigation Release No. 14444 (Mar. 17, 1995), 58 SEC Docket 3002.

<sup>15</sup>*SEC v. Softpoint, Inc.*, Litigation Release No. 14480 (Apr. 27, 1995), 59 SEC Docket 547.

<sup>16</sup>*SEC v. Digitran Systems, Incorporated*, Litigation Release No. 14375 (Jan. 4, 1995), 58 SEC Docket 1591.

<sup>17</sup>*SEC v. Bradstreet*, Litigation Release No. 14571 (July 26, 1995), 59 SEC Docket 2819.

<sup>18</sup>*In the Matter of The Cooper Companies, Inc.*, Exchange Act Release No. 35082 (Dec. 12, 1994), 58 SEC Docket 681.

<sup>19</sup>*In the Matter of Marvin E. Basson, CPA*, Exchange Act Release No. 35840 (June 13, 1995), 59 SEC Docket 1650.

<sup>20</sup>*In the Matter of C. Steven Bolen*, Exchange Act Release No. 34974 (Nov. 15, 1994), 58 SEC Docket 8.

<sup>21</sup>*In the Matter of BT Securities Corporation*, Exchange Act Release No. 35136 (Dec. 22, 1994), 58 SEC Docket 1182.

<sup>22</sup>*In the Matter of Gibson Greetings, Inc.*, Exchange Act Release No. 36357 (Oct. 11, 1995), 60 SEC Docket 1401.

<sup>23</sup>*SEC v. Schulte*, Litigation Release No. 14372 (Dec. 29, 1994), 58 SEC Docket 1476.

<sup>24</sup>*In the Matter of Van Kampen American Capital Asset Management, Inc.*, Investment Advisers Act Release No. 1525 (Sept. 29, 1995), 60 SEC Docket 1284.

<sup>25</sup>*In the Matter of Thomas M. Rogge*, Investment Advisers Act Release No. 1472 (Feb. 22, 1995), 58 SEC Docket 2474.

<sup>26</sup>*In the Matter of Askin Capital Management, LP.*, Investment Advisers Act Release No. 1492 (May 23, 1995), 59 SEC Docket 1233.

<sup>27</sup>*SEC v. Busbee*, Litigation Release No. 14387 (Jan. 23, 1995), 58 SEC Docket 1949.

<sup>28</sup>*In the Matter of Preston C. Bynum*, Exchange Act Release No. 35870 (June 20, 1995), 59 SEC Docket 1801.

<sup>29</sup>*In the Matter of Derryl W Peden*, Exchange Act Release No. 35045 (Dec, 2, 1994), 58 SEC Docket 505.

<sup>30</sup>*SEC v. Stifel, Nicolaus and Company, Inc.*, Litigation Release No, 14587 (Aug. 3, 1995), 59 SEC Docket 2964.

<sup>31</sup>*SEC v. Cochran*, Litigation Release No. 14644 (Sept. 20, 1995), 60 SEC Docket 833.

<sup>32</sup>*SEC v. Sutcliffe*, Litigation Release No. 14658(Sept. 28, 1995), 60 SEC Docket 1006.

<sup>33</sup>*SEC v. Goodman*, Litigation Release No. 14471 (Apr. 18, 1995).

<sup>34</sup>*SEC v. Rudi*, Litigation Release No. 14421 (Feb. 23, 1995), 58 SEC Docket 2495.

<sup>35</sup>*SEC v. Brumfield*, Litigation Release No. 14408 (Feb. 9, 1995), 58 SEC Docket 2225, *refiled after resolution of criminal proceedings*, Litigation Release No. 14706 (Oct. 31, 1995), 60 SEC Docket 1888.

<sup>36</sup>*SEC v. Croce*, Litigation Release No. 14655 (Sept 28, 1995), 60 SEC Docket 1004.

<sup>37</sup>*SEC v. Wagner*, Litigation Release No. 14479 (Apr. 26, 1995), 59 SEC Docket 546.

<sup>38</sup>*SEC v. Schwartzberg*, Litigation Release No. 14454 (Mar. 31, 1995), 59 SEC Docket 152.

<sup>39</sup>*SEC v. Seibald*, Litigation Release No. 14449 (Mar. 28, 1995), 58 SEC Docket 3103.

<sup>40</sup>*SEC v. Woodward*, Litigation Release No. 14548 (June 28, 1995), 59 SEC Docket 2122.

<sup>41</sup>*In the Matter of Gabelli & Company, Inc.*, Exchange Act Release No. 35057 (Dec. 8, 1994), 58 SEC Docket 520.

<sup>42</sup>*SEC v. Stratton Oakmont, Inc.*, Litigation Release No. 14355 (Dec. 15, 1994), 58 SEC Docket 806.

<sup>43</sup>*In the Matter of F.N. Wolf & Co., Inc.*, Exchange Act Release No. 34892 (Oct. 25, 1994), 57 SEC Docket 2576.

<sup>44</sup>*In the Matter of Stephen T. Strabala*, Exchange Act Release No. 36305 (Sept. 29, 1995), 60 SEC Docket 1087.

<sup>45</sup>*SEC v. Strabala*, Litigation Release No. 14667 (Sept. 29, 1995), 60 SEC Docket 1329.

<sup>46</sup>*In the Matter of H.D. Vest Investment Securities, Inc.*, Exchange Act Release No. 35946 July 10, 1995), 59 SEC Docket 2330.

<sup>47</sup>*SEC v. Saxena*, Litigation Release No. 14348 (Dec. 8, 1994), 58 SEC Docket 607.

<sup>48</sup>*In the Matter of Account Management Corporation*, Exchange Act Release No. 36314 (Sept 29, 1995), 60 SEC Docket 1157.

<sup>49</sup>*In the Matter of Roger W. Honour*, Investment Advisers Act Release No. 1527 (Sept. 29, 1995), 60 SEC Docket 1300.

<sup>50</sup>*SEC v. Kaweske*, Litigation Release No. 14399 (Feb. 6, 1995), 58 SEC Docket 2215.

<sup>51</sup>*In the Matter of John Logan Wallace*, Investment Advisers Release No. 1470 (Feb. 21, 1995), 58 SEC Docket 2470.

<sup>52</sup>*SEC v. Galleon Capital Management*, Litigation Release No. 14315 (Nov. 1, 1994), 57 SEC Docket 2939.

<sup>53</sup>*In the Matter of Anthony J. Benincasa*, Exchange Act Release No. 36273 (Sept. 25, 1995), 60 SEC Docket 0852.

<sup>54</sup>Exchange Act Release Nos. 36165 (Aug. 29, 1995), 60 FR 46653 (Sept 7, 1995); 36166 (Aug. 29, 1995), 60 FR 46660 (Sept 7, 1995); 36167 (Aug. 29, 1995), 60 FR 46667 (Sept 7, 1995); 36168 (Aug. 29, 1995), 60 FR 46637 (Sept 7, 1995); 36169 (Aug. 29, 1995), 60 FR 46644 (Sept 7, 1995) (five options exchanges); and 36296 (Sept. 28, 1995), 60 FR 52234 (Oct. 5, 1995) (NASD).

<sup>55</sup>Exchange Act Release No. 34908 (Oct. 27, 1994), 59 FR 54812 (Nov. 2, 1994).

<sup>56</sup>Exchange Act Release No. 36213 (Sept. 11, 1995), 60 FR 48078 (Sept 18, 1995).

<sup>57</sup>Order Instituting Proceedings Pursuant to Section 8A of the Securities Act of 1933 and Sections 15(b) and 21C of the Securities Exchange Act of 1934, and Findings and Order Imposing Remedial Sanctions in the Matter of BT Securities Corporation. Exchange Act Release No. 35136 (Dec. 22, 1994), 58 SEC Docket 1182.

<sup>58</sup>Exchange Act Release No. 35135 (Dec. 22, 1994), 59 FR 67358 (Dec 29, 1994), 58 SEC Docket 1264.

<sup>59</sup>Exchange Act Release No. 36270 (Sept. 22, 1995), 60 FR 50223 (Sept 28, 1995).

<sup>60</sup>Exchange Act Release No. 36310 (Sept. 29, 1995), 60 FR 52792 (Oct. 10, 1995).

<sup>61</sup>Exchange Act Release No. 35124 (Dec. 20, 1994), 59 FR 66702 (Dec. 28, 1994).

<sup>62</sup>Exchange Act Release Nos. 27445 and 29185 (Nov. 16, 1989 and May 9, 1991), 54 FR 48703 (Nov. 24, 1989) and 56 FR 22490 (May 15, 1991).

<sup>63</sup>Letter regarding Application of Rules 10b-6 and 10b-13 to New York Stock Exchange Specialists, Exchange Act Release No. 36044 (July 31, 1995), 60 FR 40212 (Aug. 7, 1995).

<sup>64</sup>Letter regarding Dividend Reinvestment and Stock Purchase Plans, Exchange Act Release No. 35041 (Dec. 1, 1994), 59 FR 63393 (Dec. 8, 1994), as modified by Letter regarding Dividend Reinvestment and Stock Purchase Plans (May 12, 1995); and Letter regarding Bank-Sponsored Investor Services Programs (Sept 14, 1995) and Letter regarding First Chicago Trust Company of New York (Dec. 1, 1994).

<sup>65</sup>Letter regarding Legg Mason Wood Walker (Aug. 24, 1995); Letter regarding Bear Stearns Securities Corporation (June 14, 1995); Letter regarding U.S. Clearing Corporation (Apr. 11, 1995).

<sup>66</sup>Letter regarding CS Holding (Mar. 31, 1995),. [1995] Fed. Sec. L. Rep. (CCH) 1177018.

<sup>67</sup>Exchange Act Release No. 33137 (Nov. 3, 1993), 58 FR 60324 (Nov. 15, 1993).

<sup>68</sup>Letter regarding Distributions of Certain United Kingdom Securities and of Certain Securities Traded on SEAQ International, Exchange Act Release No. 35234 (Jan. 10, 1995), 60 FR 4644 (Jan. 24, 1995).

<sup>69</sup>Letter regarding Distributions of Certain Dutch Securities, Exchange Act Release No. 36412 (Oct. 19, 1995), 60 FR 55391 (Oct. 25, 1995).

<sup>70</sup>Exchange Act Release No. 33741 (Mar. 9, 1994), 59 FR 12748 (Mar. 17, 1994).

<sup>71</sup>Exchange Act Release No. 34961 (Nov. 10, 1994), 59 FR 59590 (Nov. 17, 1994).

<sup>72</sup>Letter from Robert L. D. Colby, Deputy Director, Division of Market Regulation, SEC, to John S. Overdorff, Chair, and Gerald J. Laporte, Vice-Chair, Securities Law and Disclosure Committee, National Association of Bond Lawyers (June 23, 1995); Letter from Catherine McGuire, Chief Counsel, Division of Market Regulation, SEC, to John S. Overdorff, Chair, Securities Law and Disclosure Committee, National Association of Bond Lawyers (Sept 19, 1995).

<sup>73</sup>Letters dated June 22, 1995 from Brandon Becker, Director, Division of Market Regulation, SEC, to: Michael R. Bloomberg, Pres., Bloomberg, L.P.; Daniel Heimowitz, Exec. V.P., Moody's Investor Services; Robert C. Bulik, Exec. V.P., Disclosure, Inc.; Joel

Mandelbaum, Pres., Thomson Municipal Services Group; and Aaron V. Klapow, V.P., Kenny S&P Information Services. Also, Letter from Robert Colby, Deputy Director, Division of Market Regulation, SEC, to Joel Brenner, Storch & Brenner (Oct. 27, 1995).

<sup>74</sup>Exchange Act Release No. 34961 (Nov. 10, 1994), 59 FR 59590 at 59603-59604 (Adopting Release) (Nov. 17, 1994).

<sup>75</sup>1994 Adopting Release, *id.*, 59 FR at 59604. There is no requirement that a SID be an instrumentality of the state. A SID may be a private organization that has been designated by the state to function as its SID.

<sup>76</sup>Letter regarding Ontala Forest Products, Inc. (Dec. 14, 1994).

<sup>77</sup>Letter regarding Browning-Ferns Industries, Inc. (June 20, 1995).

<sup>78</sup>Letter regarding First of America Brokerage Service, Inc. (Sept 28, 1995).

<sup>79</sup>Exchange Act Release No. 34962 (Nov. 10, 1994), 59 FR 59612 (Nov. 17, 1994), 57 SEC Docket 3014.

<sup>80</sup>Letter regarding Investment Company Institute (Aug. 1, 1995).

<sup>81</sup>Letter regarding Public Securities Association (Sept. 29, 1995).

<sup>82</sup>Exchange Act Release No. 35224 (Jan. 12, 1995), 60 FR 4040 (Jan. 19, 1995), 58 SEC Docket 1662.

<sup>83</sup>Exchange Act Release No. 35990 (July 19, 1995), 60 FR 38384 July 26, 1995).

<sup>84</sup>Exchange Act Release No. 36145 (Aug. 23, 1995), 60 FR 45200 (Aug. 30, 1995).

<sup>85</sup>Exchange Act Release No. 35314 (Feb. 1, 1995), 60 FR 7241 (Feb. 7, 1995).

<sup>86</sup>Exchange Act Release No. 36088 (Aug. 10, 1995), 60 FR 42930 (Aug. 17, 1995).

<sup>87</sup>Exchange Act Release No. 35637 (Apr. 21, 1995), 60 FR 20891 (Apr. 28, 1995).

<sup>88</sup>Exchange Act Release No. 36102 (Aug. 14, 1995), 60 FR 43626 (Aug. 22, 1995).

<sup>89</sup>Exchange Act Release No. 35038 (Dec. 1, 1994), 59 FR 63652 (Dec. 8, 1994).

<sup>90</sup>Exchange Act Release No. 35039 (Dec. 1, 1994), 59 FR 63656 (Dec. 8, 1994).

<sup>91</sup>Exchange Act Release No. 35040 (Dec. 1, 1994), 59 FR 63662 (Dec. 8, 1994).

<sup>92</sup>17 CFR 240.17f-1 (1994).

<sup>93</sup>Exchange Act Release No. 35341 (Feb. 8, 1995), 60 FR 8426 (Feb. 14, 1995).

<sup>94</sup>Exchange Act Release No. 36324 (Sept 29, 1995), 60 FR 52436 (Oct. 6, 1995).

<sup>95</sup>Exchange Act Release No. 36323 (Sept 29, 1995), 60 FR 52440 (Oct. 6, 1995).

<sup>96</sup>Exchange Act Release No. 35121 (Dec. 19, 1994), 59 FR 66570 (Dec. 27, 1994).

<sup>97</sup>Exchange Act Release No. 35751 (May 22, 1995), 60 FR 27997 (May 26, 1995).

<sup>98</sup>Exchange Act Release No. 35059 (Dec. 7, 1994), 59 FR 64455 (Dec. 14, 1994).

<sup>99</sup>Exchange Act Release No. 36076 (Aug. 9, 1995), 60 FR 42200 (Aug. 15, 1995).

<sup>100</sup>Exchange Act Release No. 36211 (Sept 8, 1995), 60 FR 48182 (Sept 18, 1995).

<sup>101</sup>Exchange Act Release No. 36403 (Oct. 20, 1995), 60 FR 54898 (Oct. 26, 1995).

<sup>102</sup>Exchange Act Release No. 35990 (July 19, 1995), 60 FR 38384 (July 26, 1995).

<sup>103</sup>Exchange Act Release No. 35428 (Feb. 28, 1994), 60 FR 12583 (Mar. 7, 1995).

<sup>104</sup>Exchange Act Release No. 35953 (July 11, 1995), 60 FR 36843 (July 18, 1995).

<sup>105</sup>Exchange Act Release No. 35482 (Mar. 13 1995), 60 FR 14806 (Mar. 20, 1995).

<sup>106</sup>Exchange Act Release No. 35132 (Dec. 21, 1994), 59 FR 67743 (Jan. 25, 1995).

<sup>107</sup>Exchange Act Release No. 35198 (Jan. 6, 1995), 60 FR 3286 (Jan. 13, 1995).

<sup>108</sup>Exchange Act Release No. 35787 (May 31, 1995), 60 FR 30324 (June 8, 1995).

<sup>109</sup>Exchange Act Release No. 35557 (Mar. 31, 1995), 60 FR 17598 (Apr. 6, 1995).

<sup>110</sup>Exchange Act Release No. 36091 (Aug. 10, 1995), 60 FR 42931 (Aug. 17, 1995).

<sup>111</sup>Exchange Act Release No. 36162 (Aug. 29, 1995), 60 FR 46138 (Sept. 5, 1995).

<sup>112</sup>Investment Company Act Release No. 20915 (Feb. 23, 1995), 58 SEC 2389.

<sup>113</sup>Investment Company Act Release No. 20916 (Feb. 23, 1995), 58 SEC Docket 2487.

<sup>114</sup>Investment Company Act Release No. 20917 (Feb. 23, 1995), 58 SEC Docket 2401.

<sup>115</sup>Investment Company Act Release No. 21259 (July 27, 1995), 59 SEC Docket 2793.

<sup>116</sup>Investment Company Act Release No. 21341 (Sept. 8, 1995), 60 SEC Docket 524.

<sup>117</sup>Investment Company Act Release Nos. 20874 (Feb. 1, 1995), 58 SEC Docket 1970 and 21332 (Sept. 1, 1995), 60 SEC Docket 0413.

<sup>118</sup>Investment Company Act Release No. 21217 (July 19, 1995), 59 SEC Docket 2513.

<sup>119</sup>Investment Company Act Release No. 21260 (July 27, 1995), 60 FR 39574 (Aug. 2, 1995).

<sup>120</sup>*Frank Russell Investment Company*, Investment Company Act Release Nos. 21108 (June 2, 1995), 59 SEC Docket 1503 (Notice),

and 21169 (June 28, 1995), 59 SEC Docket 2105 (Order); *The Managers Funds and The Managers Funds, L.P.*, Investment Company Act Release Nos. 21354 (Sept. 13, 1995), 60 SEC Docket 692 (Notice), and 21412 (Oct. 11, 1995), 60 SEC Docket 1439 (Order); *Consulting Group Capital Markets Funds and Smith Barney Mutual Funds Management Inc.*, Investment Company Act Release Nos. 21318 (Aug. 23, 1995), 60 SEC Docket 109 (Notice), and 21366 (Sept 19, 1995), 60 SEC Docket 823 (Order); *Tiff Investment Program, Inc. and Foundation Advisers Inc.*, Investment Company Act Release Nos. 21268 (Aug. 3, 1995), 59 SEC Docket 2952 (Notice), and 21328 (Aug. 30, 1995), 60 SEC Docket 316 (Order).

<sup>121</sup> *Vanguard STAR Fund*, Investment Company Act Release Nos. 21372 (Sept. 22, 1995), 60 SEC Docket 983 (Notice), and 21426 (Oct. 18, 1995), 60 SEC Docket 1630 (Order); *T. Rowe Price Spectrum Fund, Inc.*, Investment Company Act Release Nos. 21371 (Sept. 22, 1995), 60 SEC Docket 681 (Notice), and 21425 (Oct. 18, 1995), 60 SEC Docket 1628 (Order).

<sup>122</sup> *Vanguard Special Tax-Advantaged Retirement Fund, Inc.*, Investment Company Act Release Nos. 14153 (Sept 12, 1984), 31 SEC Docket 437 (Notice), and 14361 (Feb. 7, 1985), 32 SEC Docket 549 (Order); *T. Rowe Price Spectrum Fund, Inc.*, Investment Company Act Release Nos. 17198 (Oct. 31, 1989), 44 SEC Docket 515 (Notice), and 17242 (Nov. 29, 1989), 44 SEC Docket 1751 (Order), *as amended by* Investment Company Act Release Nos. 18816 (June 29, 1992), 51 SEC Docket 1380 (Notice), and 18865 (July 25, 1992), 51 SEC Docket 2419 (Order).

<sup>123</sup> H.R. 1495, 104th Cong., 1st Sess. (1995).

<sup>124</sup> *PaineWebber Incorporated*, Investment Company Act Release Nos. 20755 (Dec. 6, 1994), 58 SEC Docket 589 (Notice), and 20819 (Jan. 4, 1995), 58 SEC Docket 1586 (Order); *Prudential Securities*

*Incorporated*, Investment Company Act Release Nos. 20922 (Feb. 27, 1995), 58 SEC Docket 2564 (Notice), and 20975 (Mar. 29, 1995), 58 SEC Docket 3097 (Order); *Dean Witter Reynolds, Inc.*, Investment Company Act Release Nos. 20931 (Mar. 1, 1995), 58 SEC Docket 2581 (Notice), and 20976 (Mar. 29, 1995), 58 SEC Docket 3098 (Order); *Van Kampen American Distributors, Inc.*, Investment Company Act Release Nos. 21014 (Apr. 17, 1995), 59 SEC Docket 0438 (Notice), and 21073 (May 16, 1995), 59 SEC Docket 1125 (Order).

<sup>125</sup>SMC Capital, Inc. (pub. avail Sept. 5, 1995).

<sup>126</sup>Robertson Stephens Investment Trust (pub. avail. Aug. 24, 1995).

<sup>127</sup>The T. Rowe Price Funds (pub. avail. July 31, 1995).

<sup>128</sup>Templeton Russia Fund, Inc. (pub. avail. Apr. 18, 1995).

<sup>129</sup>Citicorp Securities, Inc. (pub. avail. Aug. 4, 1995).

<sup>130</sup>Salomon Brothers Inc. (pub. avail. May 26, 1995).

<sup>131</sup>MassMutual Institutional Funds (pub. avail. Sept. 28, 1995).

<sup>132</sup>T. Rowe Price Investment Services (pub. avail. Sept 8, 1995).

<sup>133</sup>American Council of Life Ins. (pub. avail. June 20, 1995).

<sup>134</sup>Investment Company Act Release No. 21221 (July 21, 1995), 59 SEC Docket

<sup>135</sup>Investment Company Act Release No. 21216 (July 19, 1995), 59 SEC Docket 2459.

<sup>136</sup>Investment Advisers Act Release No. 1469 (Feb. 14, 1995), 58 SEC Docket 2279.

<sup>137</sup>Thompson Advisory Group,, L.P. (pub. avail. Sept. 26, 1995).

<sup>138</sup>First Call Corporation (pub. avail. Sept. 6, 1995).

<sup>139</sup>*The Regulation of Public Utility Holding Companies*, Report of the Division of Investment Management, United States Securities and Exchange Commission (June 1995).

<sup>140</sup>*Exemption of Issuance and Sale of Certain Securities by Public Utility and Nonutility Subsidiary Companies of Registered Holding Companies*, Holding Co. Act Release No. 26311 (June 28, 1995). The Council of the City of New Orleans, which has jurisdiction over the retail rates of two public-utility subsidiary companies of Entergy Corporation, a registered holding company, has filed a petition for judicial review with the Court of Appeals for the District of Columbia Circuit. Case No. 95-1434 (filed Aug. 24, 1995).

<sup>141</sup>*Exemption of Issuance and Sale of Certain Securities by Public Utility and Nonutility Subsidiary Companies of Registered Holding Companies*, Holding Co. Act Release No. 26312 (June 28, 1995).

<sup>142</sup>*Exemption of Acquisition by Registered Public-Utility Holding Companies of Securities of Nonutility Companies Engaged in Certain Energy-Related and Gas-Related Businesses*, Holding Co. Act Release No. 26313 (June 28, 1995).

<sup>143</sup>*CINergy Corporation*, Holding Company Act Release No. 26146 (Oct. 21, 1994).

<sup>144</sup>*Southern Company*, Holding Company Act Release No. 26211 (Dec. 30, 1994).

<sup>145</sup>*SEC v. Cogenex, Inc.*, Holding Company Act Release No. 26232 (Feb. 15, 1995).

<sup>146</sup>*Central and South West Corporation*, Holding Company Act Release No. 26293 (May 18, 1995).

<sup>147</sup>*The Columbia Gas System, Inc.*, Holding Company Act Release No. 26361 (Aug. 25, 1995).

<sup>148</sup>Securities Act Release No. 33-7141 (Feb. 21, 1995), 58 SEC Docket 2371 and Securities Act Release No. 33-7168 (May 11, 1995), 59 SEC Docket 0727.

<sup>149</sup>Securities Act Release No. 33-7233 (Oct. 6, 1995), 60 SEC Docket 1348.

<sup>150</sup>Securities Act Release No. 33-7234 (Oct. 6, 1995), 60 SEC Docket 1358.

<sup>151</sup>Securities Act Release No. 33-7183 (June 27, 1995), 59 SEC Docket 1939.

<sup>152</sup>Securities Act Release No. 33-7184 (June 27, 1995), 59 SEC Docket 1968.

<sup>153</sup>Securities Act Release No. 33-7185 (June 27, 1995), 59 SEC Docket 1973.

<sup>154</sup>Securities Act Release No. 33-7185 (June 27, 1995), 59 SEC Docket 1973.

<sup>155</sup>Securities Act Release No. 33-7188 (June 27, 1995), 59 SEC Docket 1983.

<sup>156</sup>Securities Act Release No. 33-7186 (June 27, 1995), 59 SEC Docket 1977.

<sup>157</sup>Securities Act Release No. 33-7187 (June 27, 1995), 59 SEC Docket 1980.

<sup>158</sup>Securities Act Release No. 7189 (June 27, 1995), 59 SEC Docket 1991.

<sup>159</sup>Securities Act Release No. 7189 (June 17, 1995), 59 SEC Docket 1991.

<sup>160</sup>Securities Act Release No. 7190 (June 27, 1995), 59 SEC Docket 1998.

<sup>161</sup>Exchange Act Release No. 34-36356 (Oct. 11, 1995), 60 SEC Docket 1393.

<sup>162</sup>Exchange Act Release No. 34-34514 (Aug. 10, 1994), 57 SEC Docket 0932.

<sup>163</sup>Exchange Act Release No. 34-34681 (Sept 16, 1994), 57 SEC Docket 1780.

<sup>164</sup>Securities Act Release No. 33-7122 (Dec. 19, 1994), 58 SEC Docket 0865.

<sup>165</sup>Securities Act Release No. 33-7101 (Oct. 13, 1994), 57 SEC Docket 2292.

<sup>166</sup>Securities Act Release No. 33-7106 (Nov. 1, 1994), 57 SEC Docket 2748.

<sup>167</sup>Staff Accounting Bulletin No. 94 (Apr. 18, 1995), 59 SEC Docket 463.

<sup>168</sup>Proposed Statement of Financial Accounting Standards, “Consolidated Financial Statements: Policy and Procedures” (Oct. 16, 1995).

<sup>169</sup>Statement of Financial Accounting Standards No. 121, “Accounting for the Impairment of Long-Lived Assets to be Disposed Of” (Mar. 1995).

<sup>170</sup>Statement of Financial Accounting Standards, “Accounting for Stock-Based Compensation” (Oct. 1995).

<sup>171</sup>Proposed Statement of Financial Accounting Standards, “Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities” (Oct. 24, 1995).

<sup>172</sup>Compare S. 240, 104th Cong., 1st Sess. (1995) with H.R. 1058, 104th Cong., 1st Sess. (1995).

<sup>173</sup>See *generally*, H.R. 2131, 104th Cong., 1st Sess. (1995).

<sup>174</sup>Testimony of Arthur Levitt, Chairman, SEC, Concerning Municipal Bond and Government Securities Markets, Before the Senate Committee on Banking, Housing, and Urban Affairs (Jan. 5, 1995).

<sup>175</sup>See Directors, Management, and Auditors: Allies in Protecting Shareholder Interests, issued in 1995 by Public Oversight Board.

<sup>176</sup>Statement of Position 94-6, “Disclosure of Certain Significant Risks and Uncertainties (Dec. 30, 1994).

<sup>177</sup>Proposed Statement of Position, “Environmental Remediation Liabilities” (June 30, 1995).

<sup>178</sup>Report of the Special Committee on Financial Reporting, “Improving Business Reporting—A Customer Focus.”

<sup>179</sup>International Accounting Standard 32, “Financial Instruments: Disclosure and Presentation” (June 1995).

<sup>180</sup>Exposure Draft E48, Financial Instruments (Jan. 1994).

<sup>181</sup>Draft Statement of Principles, Earnings Per Share (Oct. 1993).

<sup>182</sup>Exposure Draft E50, Intangible Assets (June 1995).

<sup>183</sup>Draft Statement of Principles, Reporting Financial Information by Segment (Sept. 1994).

<sup>184</sup>Exposure Draft E49, Income Taxes (Oct. 1994)

<sup>185</sup>Draft Statement of Principles, Presentation of Financial Statements (Mar. 1995).

<sup>186</sup>Issues Paper, Retirement Benefit and Other Employee Benefit Costs (Aug. 1995).

<sup>187</sup>Release No. 33-7119 (Dec. 13, 1994).

<sup>188</sup>Release No. 33-7117 (Dec. 13, 1994).

<sup>189</sup>115 S. Ct. 1212 (1995).

<sup>190</sup>115 S. Ct 1061 (1995).

<sup>191</sup>115 S. Ct. 1447 (1995).

<sup>192</sup>61 F.3d 938 (D.C. Cir. 1995).

<sup>193</sup>115 S. Ct. 1212 (1995).

<sup>194</sup>115 S.Ct 1061 (1995).

<sup>195</sup>115 S.Ct 1447 (1995).

<sup>196</sup>501 U.S. 350 (1991).

<sup>197</sup>61 F.3d 938 (D.C. Cir. 1995).

<sup>198</sup>No. 95 Cr. 166 (S.D.N.Y. Oct. 24, 1995), 1995 WL 628312.

<sup>199</sup>45 F.3d 7 (2d Cir. 1995).

<sup>200</sup>51 F.3d 623 (7th Cir. 1995).

<sup>201</sup>17 C.F.R. 240.14(e)-3.

<sup>202</sup>52 F.3d 667 (7th Cir. 1995).

<sup>203</sup>*Swan v. SEC*, No. 95-1218 (D.D.C), appeal pending, No. 95-5376 (D.C. Cir.).

<sup>204</sup>*SEC v. Worthen*, 74-202-N (S.D. Cal).

<sup>205</sup>*SEC v. The Electronic Warehouse*, 689 F. Supp. 53 (D. Conn. 1988), aff'd per curiam, 891 F.2d 457 (1989), cert. denied, 496 U.S. 942 (1990).

<sup>206</sup>*SEC v. Price Waterhouse*, 41 F.3d 305 (2d Cir. 1994); *SEC v. Littler*, 874 F. Supp. 345 (D. Utah 1994); *SEC v. Grosby*, No. 1P921411 (S.D. Ind.); *SEC v. Adler*, CV 94-PT-2018-S (N.D. Ala.).

<sup>207</sup>*Hunter v. SEC*, 879 F. Supp. 494 (E.D. PA. 1995) *Daly v. SEC*, 95-S-285 (D. Colo.); *Kinlaw v. SEC* No. 3-93-CV-2010-T (N.D. Tex.).

<sup>208</sup>*Colello v. SEC*, No. CV-94-6022-RAP (C.D. Ca.)

<sup>209</sup>*Sequoia Partners, L.P.*, Investment Company Act Release No. 20644 (Oct. 20, 1994), 57 SEC Docket 2547.

<sup>210</sup> *Gaz Metropolitan, Inc. et al*, Holding Company Act Release No. 26170 (Nov. 23, 1994), 53 SEC Docket 246.

<sup>211</sup> *Dan A. Druz*, Exchange Act Release No. 35202 (Jan. 9, 1995), 58 SEC Docket 1621.

<sup>212</sup> *Patricia A. Johnson*, Exchange Act Release No. 35698 (May 10, 1995), 59 SEC Docket 863, *appeal filed*, No. 95-1340 (D.C. Cir.).

<sup>213</sup> *Martin Herer Engelman, Peter Paul Kim, and Lawrence David Isen*, Exchange Act Release No. 35729 (May 18, 1995), 59 SEC Docket 1038, *appeal filed*, No. 95-70564 (9th Cir.).

<sup>214</sup> *Atlanta-One, Inc., et al*, Exchange Act Release No. 35455 (March 8, 1995), 58 SEC Docket 2670, *appeal filed*, No. 95-70360 (9th Cir.).

<sup>215</sup> *Hibbard, Brown & Co, et al.*, Exchange Act Release No. 35476 (March 9, 1995), 58 SEC Docket 2769, *appeals filed*, Nos. 95-1556 (D.C. Cir.) and 95-3270 (3d Cir.).

<sup>216</sup> *In re County of Orange*, No. 94-22272-JR (Bankr. C.D. CA).

<sup>217</sup> *In re America West Airlines, Inc.*, No. 91-07505-PHX-RGM (Bankr. D. AZ).

<sup>218</sup> *In re UDC Homes, Inc.*, No. 95-558 MSB (Bankr. D. DE).

<sup>219</sup> *In re County of Orange*, No. 94-22272-JR (Bankr. C.D. CA).

<sup>220</sup> *In re House of fabrics, Inc.*, No. SV 94-50060-KL, (Bankr. C.D. Cal).

<sup>221</sup> *In re Baldwin Builders*, Nos. ND 95-13057 RR and ND 95-13058 RR (Bankr. C.D. CA).

<sup>222</sup> *In re Trans World Airlines, Inc.*, No. 95-43478-399 (Bankr. E.D. MO).

<sup>223</sup> *In re Diversified, Inc.*, No. 93-41173-293 (Bankr. N.D. OH).

<sup>224</sup> *In re Phar-Mor, Inc.*, No. 92-41599 through No. 92-41614 (Bankr. N.D. OH).

<sup>225</sup> *In re Bilzerian*, Nos. 93-486-CIV-T-24A and 94-635-CIV-T-24 E (M.D. FL).

<sup>226</sup> *In re Steven Weil* No. 95-21570-BKC-RBR (Bankr. S.D. FL).