

**1972  
ENFORCEMENT  
TRAINING  
PROGRAM**



United States  
**SECURITIES AND EXCHANGE  
COMMISSION**

WASHINGTON, D. C. 20549

SECURITIES AND EXCHANGE COMMISSION

1972 ENFORCEMENT TRAINING PROGRAM

June 19 - 23, 1972

Director of Program: Ira H. Pearce

Telephone: 202-755-1794

TENTATIVE SCHEDULE

Monday - 6/19/72

SECURITIES TRADING

9:15 - 10:00	Registration
10:00 - 10:45	Welcome-Introduction-Synopsis of Functions of SEC
11:00 - 11:30	Organized Crime- Cooperative Enforcement Programs
11:30 - 12:00	Broker-Dealer and Investment Adviser Examinations
12:00 - 12:30	Current Problems
2:00 - 4:30	The Markets (Exchange and OTC)
4:30 - 5:30	Market Surveillance

Tuesday - 6/20/72

APPLICABLE REGULATIONS

9:15 - 9:45	Mark-ups and Pricing (Interpositioning)
9:45 - 10:30	Extension and Maintenance of Credit (Regulations G, T, U, and K)
10:45 - 11:30	Broker-Dealer Financial Responsibility (Net Capital Requirements)
11:30 - 12:00	Back Office Problems
12:00 - 12:30	Investment Advisers
2:00 - 2:30	SECO.
2:30 - 4:00	Division of Corporation Finance
4:00 - 5:30	Division of Corporate Regulation

*A. D. ...*

Wednesday - 6/21/72

INVESTIGATIONS

9:15 - 9:30	Preliminary Information Available
9:30 - 10:15	Investigative Sources
10:15 - 10:45	Formal Orders
11:00 - 12:00	Conduct of Investigations
12:00 - 12:15	Scope of SEC Powers - Rules Relating to Investigations
12:15 - 12:30	Subpoena Enforcement Problems
2:00 - 3:00	Interrogation of Witnesses
3:00 - 5:30	Mock Interrogation

Thursday - 6/22/72

ENFORCEMENT ACTIONS

9:15 - 10:15	Choice of Enforcement Remedies (Suspension of Trading, Administrative Proceeding, Injunction, Contempt, Criminal)
10:30 - 12:30	Administrative Proceedings
2:00 - 4:00	Civil Injunctive Actions
4:00 - 5:30	Criminal Violations of Securities Laws

Friday - 6/23/72

TRIALS

9:15 - 10:15	Preparation for Trial
10:30 - 11:30	Trial Techniques
11:30 - 12:30	Moot Court
2:00 - 4:00	Moot Court(Continued)
4:00 - 4:30	Moot Court Critique
4:30 - 5:00	Distribution of Certificates

SECURITIES AND EXCHANGE COMMISSION

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1972 ENFORCEMENT TRAINING PROGRAM  
NOTEBOOK

UNIT I

1. SCHEDULE

Tentative Schedule  
Detailed Course Outline  
List of Lecturers  
List of Participants

2. INTRODUCTION

Work of S.E.C.  
Relevant Public S.E.C. Files

3. CURRENT PROBLEMS

33-5222 Public Offerings of Broker-Dealers  
33-5211 Multi-Level Distributorships  
34-9395 Payment of Solicitation Fees in Tender Offers  
34-9459 Sales of U.S. Government Securities  
33-5168 Sales of Unregistered Securities by Broker-Dealers  
34-8712 Adoption of Rule 10b-13  
33-4982 Spin Offs and Trading in Securities of Shells

4. THE MARKET

The Language of Investing  
NASDAQ and the OTC  
Understanding the NYSE  
NASD Training Guide  
The Specialist (NYSE)  
33-4982 Adoption of Rule 15c2-11

5. MARK-UPS AND PRICING

Regulations of the Compensation of Securities Dealers

UNIT II

6. EXTENSIONS OF CREDIT

If You Borrow to Buy Stock  
Regulations X, G, T and U  
Supplement to Regulation G  
Supplement to Regulation T  
Supplement to Regulation U

7. NET CAPITAL

Information on Registration and Regulation of Broker-Dealers  
34-8024 Net Capital Interpretation and Guide  
34-9376 Adoption of Rule 17a-13  
34-9268 Adoption of Rule 17a-11  
34-8825 Adoption of Amendment to Form X-17A-5

8. BACK OFFICE PROBLEMS

SIPC Booklet  
34-9468 Broker-Dealer Responsibilities Concerning Financial and  
Operational Condition

9. INVESTMENT ADVISERS

Information on Registration and Regulation of Investment Advisers

10. SECO

Study Outline for S.E.C. General Securities Exam  
Suitability Outline

UNIT III

11. CORPORATION FINANCE

Understanding Financial Statements (NYSE)  
33-4936 Guide for Preparation of Registration Statements  
33-5036 Guide for Preparation of Oil & Gas Offerings  
33-5231 Procedures to Curtail Time in Registration  
33-5180 Release of Information During Registration  
33-5121 Use of Legends and Stop-Transfer Instructions  
33-5101 Publication of Information During Registration  
33-5071 Reservation of Securities Out of Public Offerings  
33-5005 Misleading Character of Registrants Names

12. CORPORATE REGULATION

Objectives of the Investment Company Act  
Organization of Investment Companies  
IC-5847 Restricted Securities  
IC-7113 Investment Company Advisory Fees

13. INVESTIGATIONS

Investigative Sources and Organizing Evidence  
Investor Interview Guide

14. WITNESSES

Making the Record

Witness Instruction and Warning  
Outline of Preliminary Questions for Suspects  
Testimony Check List and Notes  
Witnesses in S.E.C. Investigations

15. CHOICE OF REMEDIES

UNIT IV

16. ADMINISTRATIVE PROCEEDINGS

Administrative Proceedings Discussion Outline

17. INJUNCTIVE ACTIONS

Outline Concerning Civil Injunctive Litigation

18. CRIMINAL MATTERS

19. TRIAL TECHNIQUES

Basic Trial Preparation  
Suggested Form for an Investigative Document List  
Manual on Trial Technique in Administrative Proceedings

20. NOTES

10 Sheets of Notebook Paper



SECURITIES AND EXCHANGE COMMISSION  
DIVISION OF TRADING AND MARKETS  
1972 ENFORCEMENT TRAINING PROGRAM

June 19 through 23, 1972

MAIN HEARING ROOM  
SECURITIES AND EXCHANGE COMMISSION BUILDING  
500 NORTH CAPITOL STREET  
WASHINGTON, D.C.

DETAILED COURSE OUTLINE

**Morning Sessions**

9:15 A.M. through 12:30 P.M.

Coffee break approximately 10:45 A.M. to 11:00 A.M.

**Afternoon Sessions**

2:00 P.M. through 5:30 P.M.

Coffee break approximately 3:30 P.M. to 3:45 P.M.

MONDAY, JUNE 19

Morning:

Registration

9:15 to 10:00

Welcome - (A. J. Yorke)

10:00 to 10:45

Introduction - (I. Pollack, S. Sporkin, C. Huge,  
I. Pearce)

Synopsis of Functions of Major Division and  
Offices of S.E.C.

- I. Division of Trading & Markets
- II. Division of Corporation Finance
- III. Division of Corporate Regulation
- IV. Office of General Counsel
- V. Office of Chief Accountant
- VI. Executive Staff, Opinions and Review,  
Hearing Examiners

11:00 to 11:30

Organized Crime - (W. Timmeny, L. Grimes)

- I. Home Office Program
- II. Strike Force Participation

Cooperative Enforcement Programs - (I. Pollack,  
S. Sporkin, C. Huge, I. Pearce)

- I. Enforcement Training
- II. Regional Enforcement Conferences
- III. Cooperation on investigation and enforcement

11:30 to 12:00

Broker-Dealer and Investment Adviser Examinations  
(A. Brown)

12:00 to 12:30

Current Problems - (I. Pollack, S. Sporkin, C. Huge)

- I. Financial and Operational Condition of Brokerage  
Firms
- II. Public Ownership of Brokerage Firms
- III. Multi-Level Distributorships
- IV. Insider Trading

Afternoon:

2:00 to 4:30

The Markets - (S. Rappaport, M. Moskowitz, R. Lewis,  
I. Pearce)

- I. Exchange Markets
  - A. How They Function
  - B. Floor and Retail Brokers
  - C. Small Orders and Block Orders
  - D. Primary and Secondary Exchange Markets
  - E. Role of the Regional Exchange
- II. The Over-The-Counter Market
- III. Third and Fourth Markets
- IV. Responsibility of the S.E.C.

4:30 to 5:30

Market Surveillance - (R. Kraut, R. Bretz, I. Pearce)  
I. Review of Exchange Surveillance  
II. O-T-C Market Surveillance  
III. Market Studies.

TUESDAY, JUNE 20

Morning:

9:15 to 9:45

- Mark-Ups, Pricing (Interpositioning) - (M. Moskowitz  
H. Meamed)
- I. NASD Mark-Up Policy
    - A. Section 1 and 4 of Art. III of Rules of Fair Practice
    - B. Interpretation pursuant to G-1 of Manual
    - C. Proceeds Transaction Rule
  - II. S.F.C. Principles
    - A. Fraud and Deceit Theory
    - B. Evidence of Current Market Prices
    - C. Problem Areas
    - D. Case Example
  - III. Interpositioning
    - A. Description
    - B. Case Examples

9:45 to 10:30

- Extension and Maintenance of Credit - (E. Weiss, J. Hart,  
I. Pearce)
- I. Regulation T
  - II. Regulations G & U
  - III. Regulation X

10:45 to 11:30

- Financial Responsibility - (E. Weiss, M. Simkin)
- I. Rule 15c3-1
  - II. Rule 17a-11
  - III. Recent Releases

11:30 to 12:00

- Back Office Problems - (S. Sporkin, A. Brown, M. Simkin)
- I. Brief History of Problem
  - II. What a Back Office Is
  - III. Regulatory Approach

12:00 to 12:30

- Investment Advisers - (E. Weiss, A. Sturdevant,  
A. Brown, C. Huger)
- I. Registration
  - II. Fee Basis
  - III. Advertising Rules

Afternoon:

2:00 to 2:30

- SECO - (M. Moskowitz, A. Brown, R. Gordon)
- I. Background
  - II. Applicability and Scope of SECO Provisions
  - III. Implementation
  - IV. Other Functions

2:30 to 4:00

Division of Corporation Finance - (R. Rowe)

- I. Registration of Securities
  - A. Full Registration
  - B. Regulation A
  - C. Regulation B.
- II. Exemptions from Registration
  - A. General Statutory Exemptions
  - B. Rule 133
  - C. Rule 144
- III. Review of Filings
  - A. Proxy Materials
  - B. Annual and Periodic Reports
  - C. Ownership Reports
  - D. Tender Offer Filings
- IV. Stop Order Investigations and Proceedings
  - A. Investigations
  - B. Hearings

4:30 to 5:30

Division of Corporate Regulation - (S. Mendelsohn)

- I. What an Investment Company is
- II. Enforcement Provisions of the Act
- III. Application of Enforcement Provisions

WEDNESDAY, JUNE 21

Morning:

- 9:15 to 9:30      Preliminary Investigative Information Available  
(N. Sameth, I. Pearce)
- 9:30 to 10:15    Investigative Sources - (N. Sameth, I. Pearce)
- 10:15 to 10:45   Formal Orders - (S. Sporkin, C. Huges, G. Fitzsimmons)  
I. Purpose  
II. Content  
III. When Appropriate
- 11:00 to 12:00   Conduct of Investigations - (K. Duffy, J. Green,  
S. Sporkin, I. Borowski, C. Huges)
- 12:00 to 12:15   Scope of S.E.C. Powers - (K. Duffy, J. Green, S. Sporkin)
- 12:15 to 12:30   Subpoena Enforcement Problems - (K. Duffy, J. Green  
S. Sporkin)  
I. Appearance  
II. Production of Books and Records  
A. 4th and 5th Amendment  
B. Attorney Client Privilege  
C. Other Claimed Privileges

Afternoon:

- 2:00 to 3:00      Interrogation of Witnesses - (K. Duffy, J. Green,  
S. Sporkin, I. Pearce, R. Jaeger)  
I. Objectives  
II. Preparation  
III. Introductory Matters  
A. Sequestration  
B. Formal Order  
C. Warnings  
D. Oath  
IV. Interrogation  
A. Procedure  
B. Techniques
- 3:00 to 5:30      Mock Interrogation - (S. Sporkin, I. Pearce, R. Jaeger)

THURSDAY, JUNE 22

Morning:

9:15 to 10:15

- Choice of Enforcement Remedies - (K. Duffy, J. Green, S. Sporkin, I. Borowski, C. Hoge)
- I. Suspension of Trading
  - II. Foreign Restricted List
  - III. Administrative Proceeding
  - IV. Injunctive Action
  - V. Criminal Referral
  - VI. Criminal Contempt
    - A. Civil
    - B. Criminal
  - VII. Parellel Proceedings Problems
    - A. Civil and Criminal
    - B. Administrative and Criminal
    - C. Loss of Administrative Subpoena Power
  - VIII. Referral to State and Local Agencies or Self-Regulatory Body.

10:30 to 12:30

- Administrative Proceedings - (K. Duffy, J. Green, S. Sporkin, C. Hoge, G. Fitzsimmons)
- I. Public v. Private
  - II. Application of Section 15(b)(7)
  - III. Supervision Charges: Section 15b(5)(E)
  - IV. Flexible Settlements and Sanctions
    - V. Content of Orders for Proceedings and Supporting Memoranda
  - VI. Suspension Pending Revocation
  - VII. Denial Proceedings
  - VIII. Back Office Cases
  - IX. Default Procedures
  - X. Review of Important Recent Cases

Afternoon:

2:00 to 4:00

- Civil Injunctive Actions - (K. Duffy, J. Green, D. Ferber, S. Sporkin, R. LaPrade)
- I. Civil Injunctive Actions
    - A. Nature and Effect of Injunctions
    - B. When Appropriate
    - C. Form and Scope of Relief Available
      - (1) Temporary Restraining Order (TRO)
      - (2) Preliminary Injunction
      - (3) Final Injunction
      - (4) Ancillary Relief
        - a. Receiver
        - b. Restitution and/or Rescission

- D. Necessary Papers in Injunctive Recommendations
  - (1) Recommendation Memorandum: Content, Checklist
  - (2) Pleadings: Form and Content
    - a. Complaint and Summons
    - b. Application for TRO
    - c. TRO
    - d. Notice of Motion for Preliminary Injunction or Order to Show Cause
    - e. Motion for Preliminary Injunction
    - f. Preliminary Injunction
    - g. Supporting Affidavits
    - h. Memorandum of Points and Authorities
    - i. Permanent Injunction
- E. Findings of Fact and Conclusions of Law
- F. Applicable Rules in Federal Rules of Civil Procedure
- G. Strategy and Problems

4:00 to 5:30

Criminal Matters - (K. Duffy, J. Keeney, S. Sporkin, W. Timmeny, D. Doherty), *W. Scheif*

- I. Nature of SEC Criminal Enforcement Program
  - A. Role of Office of Criminal Reference and Special Proceedings
  - B. When Criminal Referral Is Appropriate
- II. Content of Criminal Reference Reports
  - A. Outline or Table of Contents
  - B. The Investigation
  - C. Summary of Case
    - (1) Persons Involved
    - (2) Statutory Provisions or Rules Violated
    - (3) Factual Summary of Over-All Scheme
    - (4) Significance to Commission's Enforcement Objectives
  - D. Statements of Facts
    - (1) Footnote to all sources of Proof
  - E. Theory of Substantive Violations and Persons Chargeable Therewith
  - F. Anticipated Defenses and Rebuttal Thereof
    - (1) Importance of refuting defense of reliance on advice of counsel
  - G. Additional Investigation Required
  - H. History, Description and Evaluation of Key Persons
  - I. Jurisdiction and Venue
  - J. Recommendations
  - K. Relevant Commission Files
  - L. Appendix: Exhibits
- III. Indictments
  - A. How Many Counts:
  - B. Multiple Conspiracies



- C. How Many Defendants?
- D. Short Form Indictments: Tabular Listings
- E. Principal Violations Charged
  - (1) 1933 Act
    - a. Section 5, U.S.C. 77e
    - b. Section 17(a), 15 U.S.C. 77q(a)
  - (2) 1934 Act
    - a. Section 10(b), 15 U.S.C. 78j(b), and Rule 10b-5, 17 C.F.R. 240. 10b-5 Section 9(a), 15 U.S.C. 78i(a)
  - (3) 18 U.S.C. 2: Aiding and Abetting
  - (4) 18 U.S.C. 1341: Mail Fraud
  - (5) 18 U.S.C. 1343: Wire Fraud
  - (6) 18 U.S.C. 371: Conspiracy
  - (7) 18 U.S.C. 1001: False Statement Statute
  - (8) 18 U.S.C. 1621: Perjury
  - (9) 18 U.S.C. 1505: Obstruction of Justice
  - (10) 18 U.S.C. 2314: National Stolen Property Act
- F. Check out Jurisdictional Mailings.
- IV. Grand Jury Problems
  - A. Whether Prospective Defendant Should be called to Testify
  - B. Problems of Hearsay Before Grand Jury
  - C. Defense Access to Grand Jury Minutes
  - D. Avoiding Tainted Evidence
- V. Pre-Trial Motions
- VI. Assistance At Trial
- VII. Jury Instructions
- VIII. Appellate Problems
- IX. Other Problems
- X. Important Cases

FRIDAY, JUNE 23

Morning:

9:15 to 10:15      Preparation for Trial - (J. Peloso, R. LaPrade, R. Jaeger)

10:30 to 11:30      Trial Techniques - (J. Peloso, R. LaPrade, R. Jaeger)

11:30 to 12:30      Moot Court: Trial Of A Broker-Dealer Revocation  
Hearing (S.E.C. Washington Regional Office)

- I. Summary of Case
- II. Order for Proceedings
- III. Presentation of Commission's Case

Afternoon:

2:00 to 4:00      IV. Presentation of Defense

4:00 to 4:30      V. Critique

4:30 to 5:00      Distribution of Certificates - (A. Yorke, H. Pollack,  
I. Pollack, S. Sporkin, I. Pearce)

1972 ENFORCEMENT TRAINING PROGRAM

LIST OF LECTURERS

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CONSIDINE, DANIEL, S.E.C., CHICAGO  
COONS, WILLIAM, OFFICE OF SECY. OF STATE, ILLINOIS  
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CUSSON, MAURICE, QUEBEC SECURITIES COMMISSION, CANADA  
CYR, R., DEPT. CONSUMER & CORP. AFFAIRS, OTTAWA, ONTARIO, CANADA  
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DRAKE, MIKE, S.E.C., WASHINGTON, D.C.  
DREYER, HOWARD, STATE SECURITIES BOARD, TEXAS  
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HARRINGTON, ED, S.E.C., WASHINGTON, D.C.  
HARRIS, DEE, DEPT. OF COMMERCE, SECS. BUREAU, MICHIGAN  
HATTON, ED, S.E.C., WASHINGTON REGIONAL OFFICE  
HEALEY, JOHN F., STATE OF CONN., BANKING DIV.--SECS.  
HEE, PAUL, S.E.C., WASHINGTON REGIONAL OFFICE  
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HILLER, WILLIAM L., S.E.C., LOS ANGELES  
HIRST, J.G.R., RCMP, CRIM. FRAUD SECTION, WASH., D.C.  
HOGAN, JOHN R., FED. RESERVE SYSTEM, WASHINGTON, D.C.  
HOMER, MRS. LAURA M., FED. RESERVE SYSTEM, WASHINGTON, D.C.  
HOWARD, DICKEE M., DIVISION OF SECURITIES, MARYLAND  
HUDSON, THOMAS B., S.E.C., WASHINGTON, D.C.  
HURLEY, EDWARD, S.E.C., WASHINGTON, D.C.  
HUTCHINSON, STAFFORD, S.E.C., WASHINGTON, D.C.  
IGARTUA, OCTAVIO, MEXICO  
JAEGER, RICHARD, S.E.C., WASHINGTON, D.C.  
JOHNSTON, J. BRIAN, ONTARIO SECURITIES COMMISSION, CANADA  
JOYCE, RICHARD E., DEPT. OF LAW & PUBLIC SAFETY, DIV. CONSUMER AFFAIRS,  
BUREAU OF SECURITIES, NEW JERSEY  
KEENEY, JOHN C., DEPT. OF JUSTICE, WASHINGTON, D.C.  
KEIFNER, JACK, S.E.C., WASHINGTON REGIONAL OFFICE  
KELLEY, WILLIAM, S.E.C., CHICAGO  
KIBLER, NELSON, S.E.C., WASHINGTON, D.C.  
KING, DAVE, S.E.C., WASHINGTON, D.C.  
KIRCHHOFF, RICHARD E., COMMODITY EXCHANGE AUTHORITY, WASHINGTON, D.C.  
KLEIN, CARL R., S.E.C., WASHINGTON, D.C.  
KREMSKI, MATT, S.E.C., WASHINGTON REGIONAL OFFICE  
LAPINS, AL, S.E.C., WASHINGTON REGIONAL OFFICE  
LEVINE, BARRY, S.E.C., WASHINGTON, D.C.  
LEVIT, AL, S.E.C., WASHINGTON REGIONAL OFFICE  
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LURIA, HERB, S.E.C., WASHINGTON, D.C.  
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MALLONEE, MICHAEL R., SECURITIES COMMISSION, OKLAHOMA  
MANN, JAMES, S.E.C., WASHINGTON, D.C.  
MARTIN, DONALD W., COMMONWEALTH OF VA., STATE CORP. COMM, SEC. DIV.  
MARTINSON, TOM, S.E.C., WASHINGTON REGIONAL OFFICE  
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McCONIHE, MIKE, S.E.C., WASHINGTON, D.C.  
MENELL, HOWARD, S.E.C., WASHINGTON, D.C.  
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MILLER, BARRY, S.E.C., WASHINGTON, D.C.  
MILLER, C. DOUGLASS, FED. MARITIME COMMISSION, WASHINGTON, D.C.  
MIRABELLI, MARIO V., S.E.C., WASHINGTON, D.C.  
MOSCOWITZ, JULES, S.E.C., WASHINGTON, D.C.  
~~MONTANA~~, JAMES, S.E.C., WASHINGTON, D.C.  
NELSON, SHARON, S.E.C., WASHINGTON, D.C.  
O'BRIEN, EDWARD F., COMMODITY EXCHANGE AUTHORITY, WASHINGTON, D.C.  
O'FIESH, FRED G., DIV. OF SECURITIES, MARYLAND

O'ROURKE, MICHAEL, S.E.C., CHICAGO  
PACE, JOHN, S.E.C., WASHINGTON, D.C.  
PEARLMAN, CHARLES B., S.E.C., NEW YORK  
POTTER, MARK, S.E.C., CHICAGO  
POWERS, GRETTA, S.E.C., WASHINGTON, D.C.  
RIVERS, STEPHEN, S.E.C., WASHINGTON, D.C.  
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ROCHELEAU, PAUL R., S.E.C., BOSTON  
ROTHENBERG, JAMES L., S.E.C., WASHINGTON, D.C.  
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RUBACH, RONALD, DEPT. OF COMMERCE, SEC. BUREAU, MICHIGAN  
RUBIN, RICHARD, S.E.C., WASHINGTON, D.C.  
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STEIN, JOHN, S.E.C., ATLANTA  
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STEWART, KARL A., S.E.C., WASHINGTON, D.C.  
STOPPELMAN, JOHN, S.E.C., WASHINGTON, D.C.  
SUGGS, KENNETH E., DEPT. OF COMMERCE, SEC. DIV., ARKANSAS  
SUNDICK, GARY N., S.E.C., WASHINGTON, D.C.  
SWIFT, H. LESLIE, OFFICE OF SECY. OF STATE, ILLINOIS  
TEISMANN, KEVIN P., S.E.C., SEATTLE  
THOMAS, RONALD W., VA. STATE CORP. COMMISSION, SEC. DIVISION  
TURNER, WILLIAM, S.E.C., WASHINGTON, D.C.  
VANDER PLOEG, ANDREW, S.E.C., CHICAGO  
VANDER WAAG, ROBERT F., S.E.C., NEW YORK  
VELASCO, ANTONIO LOPEZ, MEXICO  
WALKER, CAMERON MAURICE, MANITOBA SEC. COMM., WINIPEG, MANITOBA, CANADA  
WATKINS, CLINT, S.E.C., DENVER  
WEISS, DON, S.E.C., WASHINGTON REGIONAL OFFICE  
WHEELER, THOMAS R., ATTORNEY GEN. OFFICE, MICHIGAN  
WHITESCARVER, JAMES F., JR., DISTRICT OF COL. SECURITIES COMMISSION  
WIAND, BURT, S.E.C., WASHINGTON, D.C.  
WILLETT, DONALD E., S.E.C., CHICAGO  
WOLENSKY, MICHAEL, S.E.C., ATLANTA  
ZAWITZ, STEPHEN, S.E.C., WASHINGTON, D.C.  
BRODSKY, DAVIS, ASSISTANT U.S. ATTORNEY, NEW YORK  
DRIESSEN, ROBERT S., S.E.C., WASH., D.C.

## INVESTOR INTERVIEW GUIDE

One of the most important parts of an investigation is the thorough systematic interview of investors. In order to expedite the investor interview phase of investigations, the following procedures are suggested:

### 1. USE OF QUESTIONNAIRES

When time and other circumstances permit, obtain a sampling of investor experiences by use of questionnaires or letters. If the standard form of questionnaire is used you may wish to strike the section which asks that investors send the relevant documents at this time unless you anticipate receiving sales material which you have not seen previously. Rather than being deluged with investor material (all of which must be returned) you may wish to wait until personal interviews are made to determine whether an investor's documents should be obtained.

### 2. PLANNING THE INVESTOR INTERVIEWS

Plan your investor interviews in advance by making appointments with investors. Your time is important and it is essential that the investor be given advance notice in order to collect his relevant documents and to give some thought to the matter. In this respect, I suggest the use of administrative subpoenas (or letters if subpoenas can not be used) to bring investors to our office or to a post office or federal building central to the area where investors reside. Much time can be wasted attempting to contact investors by telephone or at their home. Our experience has shown that asking these witnesses to appear every 45 minutes throughout the day affords sufficient time for each interview. Use of a subpoena also permits us to compensate investors for their appearance through the witness claim form which you should have with you to give to such witnesses. Remember that you can not discuss other aspects of a matter under investigation with investors unless public action has been taken. It is important that nothing be stated to investors which can later be used as charges that we prejudiced investors or provided them with inflammatory information detrimental to the company under investigation.



Take time to plan your questions for investors. Prepare a list of questions, or use one similar to the one attached and add to it as you learn more about what representations were made to individual investors.

### 3. THE INTERVIEW

Using your list of questions as a checklist, make notes during the interview (perhaps keying your notes to the numbered items on the checklist). Thus if an investor recalls that representation No. 20 was made to him you can merely write down 20 in your notes.

NEVER USE A REPORTER OR ANY RECORDING DEVICE IN INTERVIEWING INVESTORS.

Where there is a possibility that injunctive action may be taken obtain affidavits. Usually these affidavits can be prepared in our office after the interview from your notes, and mailed to the investor for his execution. When affidavits are not prepared, a Memorandum of Interview should be prepared summarizing the statements of the investors. This memorandum should state in full the representations made to the investor and should not merely incorporate the representations enumerated in the checklist. Remember that most investor statements, whether memoranda or affidavits, will be required to be shown to defense counsel in the event of action in a matter. As a result, accuracy is essential. Investors, like other witnesses, frequently have a tendency to state the wrong dates or amounts. Be certain to check the dates which they state against documents in their possession and other records which you may have. Permit the investor to tell his story. However, when he has finished, it is important that you inquire whether certain additional possible misrepresentations were made to him. Ask the investor to limit his recollection to oral statements as the written representations speak for themselves. However, as to both oral and written statements, it is appropriate to determine whether he relied on them in investing.

### 4. OBTAINING INVESTOR DOCUMENTS

If the investor is likely to be used as a witness, it is usually appropriate to obtain the originals of all relevant

documents. Do not obtain documents of investors who would not appear to make suitable witnesses. Photocopies should not automatically be made of all documents obtained. We should obtain originals and only if the investor objects to this procedure or specifically requests photos, should photocopies be made. Investors should be advised, in any event, that all original documents will subsequently be returned to him at the conclusion of this matter.

DO NOT OBTAIN STOCK CERTIFICATES OR OTHER SECURITIES, BUT MAKE A NOTE OF THE PERTINENT DATA ON SUCH CERTIFICATES, INCLUDING THE FOLLOWING:

- a) the number of the certificate
- b) the number of shares
- c) the exact name in which the certificate is held
- d) the date of the certificate
- e) the names of the officers signing such certificate.

Obtain the investors initials and date on the more important documents obtained from him. Place all documents obtained from each investor in an Investor Envelope, appropriately marked.

##### 5. EVALUATING THE INVESTOR-WITNESS

When you have finished interviewing an investor, grade him on a numerical or A through F system, on his expected performance value as a witness. Ask yourself the following questions:

- a) did he buy as a result of misrepresentations, oral or written, made by the proposed defendants (or did he in fact buy as a result of a tip or recommendation made by friend, neighbor, etc.)?

- b) Was he a speculator or gambler who took a risk with knowledge, or was he actually misled through concluding that the securities purchased were a sound investment?
- c) Did he lose money either as a result of holding the securities or selling them at a loss?
- d) Once he has been refreshed as to the details concerning his dealings with the subject, does he thereafter stick to his story or does he appear hesitant or uncertain regarding many details?
- e) Will the witness be believable, and make a good impression on a jury?
- f) Was the loss to the investor meaningless to him, or does it represent a substantial loss to him?

DO NOT include your evaluation of a witness in the memorandum of interview. This memo should contain ONLY a summary of the information obtained from him.

Do not become discouraged in your search for investor-witnesses. In many cases only one investor in ten can be considered a possible witness. Thus in most cases, it may be necessary to interview 50 or more investors to find sufficient witnesses.

Attachment  
Investor Checklist

INVESTOR CHECKLIST  
XYZ CORPORATION

1. Name, address and occupation.
2. Manner in which investor first became acquainted with company; persons with whom he dealt, etc.
3. Describe all personal solicitations and telephone calls with approximate dates.
4. Number of shares or other units purchased, amount per unit and dates.
5. Were stock certificates or other securities delivered? Indicate if mails were used.
6. Determine what other correspondence, brochures, maps, etc. were received through the mails.
7. Determine the manner of payment for these securities and whether funds or checks were sent through the mails.
8. Determine whether investor made any notes at the time he talked with a salesman and whether the salesman showed him materials which were not left with the investor.
9. Ask the investor to tell you what the salesman said which convinced him that he should invest in these securities.
10. Determine that the investor relied on these statements, oral or written, in purchasing the securities.
11. Inquire whether the following specific oral misrepresentations were made (this list must vary depending on the matter involved). Use questionnaire results to make an initial list of possible misrepresentations and add to the list as you talk to investors. Some of the more standard misrepresentations which may be asked about, even without any evidence that these were made, include the following:

- a) the price of this stock will double within a short time;
- b) you are getting in on the ground floor in your purchase of XYZ Corp securities;
- c) you can't lose in buying XYZ Corporation securities;
- d) a purchase of XYZ Corp. securities is not a speculation but a sound investment;
- e) we are selling these securities at below the market price;
- f) an active market for these securities exists at \$ \_\_\_\_\_ per share;
- g) XYZ Corporation is an excellent company in sound financial condition;
- h) the company is presently engaged in operations or will begin operations within a short time;
- i) the company has been operating at a profit and is expected to continue to do so;
- j) all proceeds derived from the sale of these securities will go to the company;
- k) this is an excellent buy for long-term capital gains;
- l) these securities are registered for sale with the SEC and the State authorities;
- m) these securities are being offered at below the market price, and later will be offered to the general public at much higher prices;
- n) the company has existing contracts or sales or proven reserves;
- o) we will buy back your XYZ stock any time at your request;
- p) within six months you will be able to sell half of your XYZ stock and realize your original investment.

A-1 D

INVESTIGATIVE SOURCES AND ORGANIZING EVIDENCE

I. SEC Sources

A. The Indices [Computer or Manual Use]

1. General Index in Docket Section
2. T&M Complaint Section Index
3. CFD Index of Attorneys, CPA's and Officers and Directors Listed in Securities Act Registration Statements
4. CFD Index - Comparable to Above - in Regulation A Filings
5. CFD Index of Sec. 16 Filings - by Companies or by Individuals
6. T&M Broker-Dealer and Investment Adviser Index
7. Mail and Records Index of Brief Cards
8. Public Reference Room Index of Individuals Named in SEC Releases

B. The Files

1. Basic 33 and 34 Act Registration Files - Data on Officers, Finders, Underwriters, etc. - Importance of Exhibits
2. Importance of Data in Attendant Correspondence Files
3. Transcripts of Hearing
4. Contents of Complaint Files
5. 132-3 Files
6. B-D Files and I-A Files  
(Also B-D I-A File, which is Delivered Only If Requested)
7. SV Files and Procurement of Our Releases
8. SEC 16a Files
9. SECO Applications
10. The Stock Market Study - Use of Report for Index Purposes

II. Other Governmental Sources

A. I.R.S.

1. Tax Returns - Advantage of Uncertified Returns
2. Information Obtainable From Intelligence Service

B. Department of Justice

1. Organized Crime Files - Lists, Summaries and Detailed Data
2. Contacts with Assistant U.S. Attorneys Who've Handled Cases Involving Particular Individuals
3. Immigration and Naturalization Service

C. Department of State

Passport Information - the Application - Type of Data - the  
Correspondence Files

D. Social Security

Affirmation that a Named Individual and a Named Social  
Security Number Jibe Per Their Records

E. Coast Guard

F. Department of Commerce

Union Welfare Filings

G. CIA

H. FBI

I. Post Office Department

1. Post Office Cases
2. Mail Covers

J. Agencies with Whom Individual or Company has Business Dealings

1. Maritime Sea Transportation Service
2. Small Business Administration
3. Defense Department (Contracts)

K. Data Procurable From Congressional Committees

1. Example: McClellan Committee - (Committee on Government  
Operations)

(Investigation into Federally Insured Banks)  
(Investigation of Improper Activities in Labor or  
Management Field)  
(Investigation of Gambling and Organized Crime)  
(Investigation of Organized Crime and Illicit Traffic  
in Narcotics), etc.

2. Hearings
3. Indices - As Published in Hearings Volumes and the  
Committees' Own Detailed Index Systems

L. Court Records

1. Index System in State and Federal Courts and Filed Cases
2. Index in Reported Cases  
Papers Filed With Courts can be Examined, Also Testimony and Transcripts
3. Copies of Injunctions, etc. Procurable From County Clerks

M. Real Estate Records

1. Index System of Grantors and Grantees
2. Examination of Documents, for Address of Buyers and Sellers, Details of Transactions, Stamp Tax Indication of Prices, and Identity of Settlement Company (From Whom Additional Data can be obtained)

N. Marriages, Wills, etc. Records

O. Police Records, Automobile Registration and Operators License Data

(Procurable From Local Authorities)

P. Information Re Imprisoned Persons

1. Visitors to Prisoner (From Warden)
2. Telephone Calls Made From Prison (the Telephone Company)

Q. Data Procurable From State and Foreign Agencies

1. State Governments - Attorney General's Office
2. Canada
3. Other Countries

III. Data Procurable From Directories

A. City Directories (For All Except Largest Cities) Published By Polk's and Others

Individual, Spouse's Name, Business, Address, Occasionally Children's Names

Telephone Numbers in Back Section; Residents, by Streets, Offices and Directories of Business

[Location - Our Library, Library of Congress, At Publisher's Local Office - Information Procurable By Telephone From Polk's Librarian or Local Office]



B. Martindale Hubbell

Attorney's Names, Affiliated Firm, Date of Birth, College and Law Schools and Date Admitted to Bar  
Biographical Section Gives Fuller Information Including Principal Clients of Law Firm

C. Accountants', etc. Directories

D. Congressional Directories

E. Directory of Directors - By Individuals, By Companies

F. Who's Who

1. Who's Who in America
2. Regional Who's Who (South and Southwest, East, etc.; Who's Who in Mass., etc.)
3. Who's Who in Commerce and Industry

G. Security Dealers of North America - For B-D Information, Especially Re Chief Employees

IV. Telephone Company Facilities

1. Telephone Directories (Library has Current for Certain Cities) Local Libraries for Others, Library of Congress has Mostly All
2. Cross-Index Directories
3. Use of "Information" to Obtain Addresses and Phone Numbers  
- All Above May Indicate a Relationship of Individuals Who Use Common Address or Phone
4. Telephone Toll Slips
5. Opening Account Cards
6. Installation Records
7. Data Processing Center for Names of Subscribers of Phones No Longer Operating
8. Obtaining Copies of Basic Telegrams, Referred to in Toll Charges

V. Airline Companies' Records of Tickets and Charges

VI. Hotel Records, Room and Other Charges; Names of Guests; Records of Local and Toll Telephone Calls

VII. Bank Records (Subpoena Necessary)

1. Opening Account Cards
2. Loan Applications - Loan Records, Collateral Cards

3. Safe Vault Records and Entry Cards
4. Checks Issued - Including Cancellations, Showing Bank Used By Payees
5. Checks Deposited - Showing Makers' Banks (Use of Rand McNally Banking Directory for Bank Identifying Numbers)
6. Correspondence Files

VIII. Brokerage Records (No Subpoena Necessary)

1. Clearing Corporation Final Reconciliation Records
2. Exchange and NASD Files - Specialist and Registered Trader Reports
3. Opening Account Cards
4. Customer's Statements
5. Correspondence Files
6. Ledger Sheets Showing Transactions
7. Firms' Automated Surveillance and Record Keeping Data
8. Identification of Registered Representative
9. Interview Re Opening of Accounts
10. Trading Questionnaires

IX. Credit Agencies and Credit Card Organizations

1. Diners Clubs, American Express, Hilton, etc.
2. Dunn and Bradstreet Reports
3. Bishop Service
4. Proudfoot Reports
5. World Wide Information Service
6. Exchange Firms Information Corporation
7. Local Credit Agencies, Such as Locally Here: Central Charge Services, National Credit Bureau, Stones Merchantile Agency

X. Newspaper and Periodical Data

1. Funk & Scott Index of Corporate Items in Newspapers and Periodicals
2. New York Times Index
3. Wall Street Journal Index
4. Industrial Arts Index
5. Fortune Magazine Index
6. New Yorker, Fairchild Publications, etc. Indices (Procurable From Respective Offices)
7. Newspaper Morgues and Their Indices
8. S & P Corporation Records
9. Moody's

[The Public Indices and Underlying Source Material are Available in Library of Congress or the SEC Library]

XI. Use of Books Dealing With Securities "Wheeler-Dealers" and Other Characters

(Green Felt Jungle, Fight for Control, Brotherhood of Evil, The Operators Revolt in Mafia, The Insiders, Truman Scandals, etc. Almost All Contain Indices of Persons Mentioned)

XII. Information Procurable From NASD Re Members' Employees

1. Copies of NASD Applications Obtainable Through Moskowitz's Section
2. D & D Reports on Past Employees

XIII. Information Re Price and Volume in Securities Trades

1. SEC Library
2. I.S.L. Daily Stock Prices
3. Market Surveillance Unit

XIV. Building Directories

1. Office Building Lobby Bulletins
2. Names on Office Doors

XV. Other

1. Use of Persons Who are Acquainted With Individual Under Investigation - Associates and Other Persons in Same Business
2. Discussions With Staff Members of SEC or Other Government Bureaus Who have Worked on Other Cases Involving Same or Associated Persons
3. Use of Index Book in Complicated Cases

XVI. Organization of Information

A. Witness Envelopes

1. Investor Statements
2. Sales Materials or Correspondence

B. Document Envelopes

1. Corporate Records
2. Litigation Pleadings and Decisions
3. Defendant's Prior Testimony for Cross Examination
4. Correspondence From Defendants to Third Parties

C. Proving Documentary Evidence

1. By Recipient
2. By Custodian (Federal Shopbook Rule)
3. Commission Records by Authentication or Testimony

XVII. Use of Computer and Market Surveillance

XVIII. Mail Covers

IXX. Procedures in Obtaining Tax Returns

XX. Use of Tape Recordings

**STUDY OUTLINE  
FOR THE  
SECURITIES AND  
EXCHANGE  
COMMISSION  
GENERAL SECURITIES  
EXAMINATION**

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

## STUDY OUTLINE FOR THE SECURITIES AND EXCHANGE COMMISSION GENERAL SECURITIES EXAMINATION

Section 15(b)(8) of the Securities Exchange Act of 1934 gives the Commission authority by which it may "appropriately classify brokers and dealers and persons associated with brokers and dealers (taking into account relevant matters, including types of business done and nature of securities sold)" and "require persons in any such class to pass examinations."

The Special Study of Securities Markets, transmitted to Congress by the Commission in 1963, recognized the qualifications examination as a "basic regulatory control in respect to competence." The prevailing practice of the majority of State and self-regulatory bodies in requiring the completion of a general securities examination as a prerequisite for entry into the securities business by salesmen and others gave added impetus to the adoption by the Commission of Rule 15b8-1.

Rule 15b8-1 prohibits any nonmember broker or dealer, as defined by the rule, from effecting any transactions over-the-counter unless every associated person within certain defined categories has successfully completed a general securities examination covering a "core of basic subjects."

The General Securities Examination which is administered to associated persons of nonmember brokers and dealers is designed to determine the extent of the applicant's knowledge of subjects considered essential to his work. This Study Outline has been prepared with a view toward aiding associated persons in their preparation for the General Securities Examination by highlighting those subject areas which form the basis for the examination questions. It should be used in conjunction with the Training Guide and the bibliographic materials suggested.

## STUDY OUTLINE FOR QUALIFICATION EXAMINATION

### I. Fundamentals of Securities

#### A. Elements of Finance--Basic concepts and definitions of terms in the fields of corporation finance and accounting, taxation, money and banking, and public finance.

##### 1. Corporation Finance and Accounting

- |  |   |
|--|---|
| a. Common Stock—<br>authorized, out-<br>standing, unissued | Rights<br>Warrants<br>Splits<br>When issued |
| Treasury stock   | Dividends                                   |
| Preferred stock  | Stock dividends                             |
| Par value  | Bearer and registered<br>certificates       |
| Equity   |   |
| Equity security  |   |
| Market value   |   |
| b. Bonds, general  | Serial bonds                                |
| Premium  | Revenue bonds                               |
| Discount   | Retirement of bonds                         |
| Debenture bonds  | Coupons                                     |
| Convertible bonds  | Income bonds                                |
| Mortgage bonds   |   |
| c. Guaranteed stocks and<br>bonds                          | Collateral trust certificates               |
| Sinking fund   | Voting trust certificates                   |
| d. Capitalization  | Amortization                                |
| Asset value  | Depletion                                   |
| Gross capital  | Depreciation                                |
| Funded debt  | Retained earnings                           |
| Net tangible asset<br>value                                | Good will                                   |
| Stated value   | Book value                                  |
| Fiscal year  | Diversification                             |
|  | Current assets                              |
| e. Rights of stockholders                                  | Proxies                                     |
| Liability of stock-<br>holders                             | Pre-emptive rights                          |
| Voting   |   |

f. Stock registrar                      Transfer agent  
Street name

## 2. Analysis and Interpretation of Financial Statements

The income statement	Risk
Managerial performance	Working capital
Evaluation of reported earnings	Current ratio and standard minimum
Inventory	Acid test
Contingencies	Cash holdings
Earnings	Total sales to merchandise inventory
Margin of profit	Operating deficit
Price-earnings ratio	
Operating profit	
The balance sheet	
Capital structure	

## 3. Taxation—Definitions and Basic Concepts

Capital gains	Double taxation of dividends
Dividend tax credit and exclusion	Gifts in anticipation of death
Short and long-term gains	Passing of securities at death to estate at current market value
Realization of gains	Transfer tax rates
Five-year carryover	Referring legal questions to counsel
Establishing a securities tax loss or gain	
Tax-exempt securities	

## 4. Money and Banking

Role of the U.S. Treasury and the Federal Reserve in the monetary system	Definition of bills, notes, commercial paper, call loans to brokers, prime rate
Changes in interest rates	

## B. The Analysis of Securities

### 1. Sources of Financial Information

### 2. Industry Analyses



### 3. Factors in Stock Analysis

Growth stock	Leverage analysis
Blue chip	Mergers
Special situation	Consolidations
Income stock and defensive issue concepts and standards	Refinancing Recapitalization Receivership or reorganization
Investment vs. speculation	"Watered stock"
Stock valuation	

### 4. Corporate Senior Securities

Analysis and standards for stock, income bonds, and guaranteed stocks	corporate bonds, preferred guaranteed stocks
Effect of premium and discount on yield	Appraisal of conversion privilege
Bond ratings	Callable provisions
Convertible bond price correlation to stock or bond market	

### 5. Governments

Analysis and standards for statutory authority bonds	Analysis and standards for Federal, state, municipal and statutory authority bonds
Comparative yields	Definition of Treasury bills and notes
Investment appeal of Treasury notes and certificates	Series E bonds
Tax status	

### 6. Market Analysis

Popular short and long- term forecasting systems	Popular stock indexes
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## II. Securities Markets

### A. Comparative Markets

1. Kind of businesses whose securities are traded on the principal national securities exchanges and over-the-counter markets

2. Nature of each securities market (auction, negotiated, etc.)

B. Investment Banking

Functions of the investment banker	Stabilization Competitive bidding
Underwriting procedures	Best efforts
Primary and secondary distributions	Private vs. public offerings
"Red herring" or preliminary prospectus	
Indication of interest	
Buying syndicates	

C. Over-the-Counter Trading

How over-the-counter market operates	The National Daily Quotation Service ("Pink Sheets," etc.)
Types of securities traded	"Boiler Room"
Agency and dealer relationship with customers	
Quotations spread	

D. Foreign Securities

E. Arbitrage

III. Investment Companies

A. Applicable Law

1. Securities Act of 1933—provisions covering registration, prospectus and shareholder report
2. Securities Exchange Act of 1934—provisions covering proxies and periodic reports of portfolio changes
3. Investment Company Act of 1940

Definitions and provisions  
"Regulated investment company"  
Maintaining the public offering price

4. SEC Statement of Policy—and published interpretations  
of Statement of Policy

Rates of return	Cost averaging and
Capital gains vs. income	contractual plans
Explanation of risks	Sales commissions
Government regulation	
Custodial services	
Redemption	
Comparisons	
Management claims	
Continuous investment programs	

5. Internal Revenue Code

- a. Passing through of taxation of dividends paid to and  
capital gains realized by mutual funds
- b. Required dividend and interest payout
- c. Capital gains distribution
- d. Individual reporting of income and gains from mutual  
funds

B. Sources of information

1. Prospectus
2. Annual Reports
3. Newspaper Price Tables

C. Fundamentals of Investment Companies

1. Understanding of Terms such as:

Capitalization	Custodians
Fund appreciation	Dividend and capital
Unrealized appreciation	gains distribution
Leverage	Custodian charges
Management	Custodian or trustee fee

Management fees	Sponsor
Operating costs	Net investment income
Expense ratio	

2. Types and Characteristics

- a. Diversified common stock
- b. Balanced
- c. Income
- d. Bond and Preferred stock

3. Purchases and Sales—Open-End Investment Companies

- a. Selling charges
  - Purchase by dollar amounts
  - Quantity discounts
  - Dollar cost averaging
- b. Changing number of shares      Methods of issue and redemption  
Basis for offering and redemption price      Marketability
- c. Automatic dividend reinvestment
- d. Accumulation plans
  - (1) Level charge-open account (voluntary plan)
    - Life insurance features
    - Liquidation provisions
  - (2) Prepaid charges—contractual
    - Penalty of front-end load
    - Fixed period
    - Specified payment or investment
    - Life insurance feature
    - Liquidation provisions
  - (3) Regular withdrawal plans

#### IV. Federal Laws

##### A. Securities Act of 1933

- Prospectus
- False statements
- Secret profits
- Improper sales of securities
- Sales of unregistered securities

##### B. Securities Exchange Act of 1934

- Section 3(a)(12) exempt securities
- Section 15(b)(1)-(3)—registration of brokers and dealers
- Section 10—regulation of the use of manipulative and deceptive devices
- Section 9—manipulation, wash sales, inducing purchases or sales, false and misleading statements, unlawful use of puts, calls, and other options
- Section 15A—(Maloney amendment)
- Section 15c(1)—manipulation, deceptive or fraudulent devices or contrivances
- Section 26—unlawful representation

##### C. Regulation T; Regulation U

#### V. State Laws

##### A. Blue Sky

##### B. Prudent Man Rule

**REFERENCES FOR  
GENERAL SECURITIES EXAMINATION**

Unless otherwise noted, copies of the following books and reference material should be obtained directly from the publisher indicated below or from a book store.

1. A standard text on Corporation Finance may be used in reviewing definitions of basic terms, *e.g.*, Barnes and Noble College Outline Series, *Corporation Finance*, New York: Barnes and Noble, Inc., \$1.75. Order from Barnes and Noble, Inc., 105 Fifth Avenue, New York, N.Y., 10003.
2. Loll, L. M., Jr., & Buckley, J. G. *The Over-the-Counter Securities Markets: A Review Guide*. Englewood Cliffs, N.J.: Prentice-Hall, Inc., 1967. \$8.95. Quantity price and discount available for training purposes. Order from Prentice-Hall, Inc., Englewood Cliffs, N.J., 07631.
3. Leffler, G. L. Revised by L. C. Farwell. *The Stock Market* (3d ed.) New York: Ronald Press, 1963. \$8.50. Order from Ronald Press Co., 15 East 26th Street, New York, N.Y., 10010.
4. Jordan, D. F. & Dougall, H. E. *Investments* (7th ed.) Englewood Cliffs, N.J.: Prentice-Hall, Inc., 1960. \$9.75. Quantity price and discount available for training purposes. Order from Prentice-Hall, Inc., Englewood Cliffs, N.J., 07631.
5. Loeser, J. C. *The Over-the-Counter Securities Market*. New York: National Quotation Bureau, Inc., 1940. \$2. Order from National Quotation Bureau, Inc., 46 Front Street, New York, N.Y.
6. Graham, B. & McGolrick, C. *The Interpretation of Financial Statements*. (Rev. ed.) New York: Harper & Bros., 1964. \$2.95. Order from Harper & Bros., 49 East 33d Street, New York, N.Y.

## SUPPLEMENTAL READINGS

7. Wiesenberger, A. *Investment Companies*. New York: Arthur Wiesenberger & Co., \$40, includes quarterly supplements on performance. Order from Arthur Wiesenberger Services, Division of Nuveen Corporation, 61 Broadway, New York, N.Y., 10006.
8. Loss, L. *Securities Regulation* (2d ed.) Boston: Little, Brown & Co., 1961, 3 vols. \$60. Order from Little, Brown & Co., 34 Beacon Street, Boston, Mass., 02106.
9. Investment Bankers Association of America. *Fundamentals of Municipal Bonds*. Washington, D.C.: \$3. Order from Investment Bankers Association of America, 425 13th Street NW., Washington, D.C., 20004.

RELEVANT PUBLIC S.E.C. FILES AND MATERIALS

- 0-XXXX-2 Periodic reports summarizing financial and other corporate information filed pursuant to Section 12(g) of the Securities Exchange Act by larger publicly held companies whose securities are not listed on any national securities exchange.
- 1-XXXX-2 Periodic reports summarizing financial and other corporate information filed pursuant to Section 13(a) of the Securities Exchange Act by publicly held companies whose securities are registered on a national securities exchange.
- 2-XXXX-1 Registration Statement containing extensive financial and other corporate information concerning securities offered for public interstate sale filed pursuant to Section 6 of the Securities Act of 1933.
- 2-XXXXX-2 Periodic reports summarizing financial and other corporate information filed pursuant to Section 15(d) of the Exchange Act by certain publically held companies smaller than those covered by Section 12(g) in order to keep the information in the registration statement reasonably current.
- 2-XXXX-5 Testimony taken pursuant to Section 8(e) of the Securities Act in a public stop order proceeding to determine whether the effectiveness of a registration statement should be suspended.
- 3-XXXX-1 Proceedings in public Commission administrative hearings including testimony, exhibits, arguments, briefs, motions, decisions and exceptions.
- 6-XXXX-1 Reports of beneficial ownership of equity securities filed pursuant to Section 16(a) of the Exchange Act by officers, directors and principal stockholders of issuers required to file periodic reports under Sections 12(g) and 13(a) above. (Forms 3 and 4).
- 8-XXXX-1 Application for registration with the Commission as a broker and dealer filed pursuant to Section 15(b) of the Exchange Act including financial and background information with amendments necessary to keep such application current.



- 20-XXXX-1 Offering sheets for fractional undivided interests in oil or gas rights, filed pursuant to Regulation B under the Securities Act.
- 24ROXXXX-1 Offering circular containing financial and other corporate information relating to a public interstate offering of securities not exceeding \$500,000 filed pursuant to Regulations A and E (S.B.I.C.) under the Securities Act.
- 801-XXXX-1 Application for registration with the Commission as an investment adviser including financial and background information with amendments necessary to keep such application current, filed pursuant to Section 203 of the Investment Advisers Act of 1940.
- 811-XXXX-1 Notification of registration of an investment company and registration statement covering an offering of securities therein, filed pursuant to Section 8 of the Investment Company Act of 1940.
- 811-XXXX-2 Periodic reports summarizing financial and other developments to keep reasonably current the information in the above registration statement, filed pursuant to Section 30 of the Investment Company Act.
- D.J. XXXX Court papers and other documents relating to criminal actions involving violations of the Federal securities laws.
- Lit. XXXX Court papers and other documents relating to civil actions to which the Commission is a party.
- Civil Misc. Court papers and other documents relating to civil actions involving alleged violations of the federal securities laws to which the Commission is not a party.

I. H. Pearce 6/72

For RELEASE Monday, January 3, 1972

SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D. C. 20549

SECURITIES ACT OF 1933  
Release No. 5222

PUBLIC OFFERINGS OF REGISTERED BROKER-DEALERS

The Commission today noted that a number of registered broker-dealers have filed registration statements under the Securities Act of 1933 relating to proposed public offerings of their securities. Because of the difficult disclosure problems involved, initial processing of some of these filings has been time consuming. In several instances, issuers and underwriters have found it necessary to revise time schedules for public offerings.

In view of the Commission's limited experience with publicly held broker-dealers, the Commission has determined not to propose a form for registration statements under the Securities Act for broker-dealers or to propose guidelines for disclosures in such registration statements. However, in order to minimize delays in the review of registration statements filed by broker-dealers, the Commission is publishing the following comments and suggestions by its staff to assist issuers, accountants, attorneys, underwriters and others in the preparation of such registration statements. These comments and suggestions are tentative and may be revised or extended as the staff accumulates experience with offerings by broker-dealers.

1. Risk Factors

The forepart of the prospectus should include a carefully organized series of short, concise, subcaptioned paragraphs summarizing the principal risk factors connected with the offering. (See Guide 6 of Securities Act Release No. 4936.) These risk factors should include matters specifically affecting the issuer such as operating losses, lack of adequate capitalization, and record keeping or "back office" problems. Where applicable and material, the effects on reported operating results of such factors as new commission rate schedules, negotiated commission rates and use of customers free credit balances should be discussed briefly. Other factors which affect the securities industry as well as particular issuers, such as the state of the economy, recent trends in securities trading volume and price levels, the failure of other firms, changes in net capital requirements, significant regulatory and competitive matters and pending hearings and inquiries, should be enumerated. Cross references should be made to other portions of the prospectus where these factors are discussed in more detail.

## 2. Financial Statements

The general requirements as to financial statements are set forth in the Commission's forms for registration under the Securities Act. Generally, broker-dealers have used the Commission's Form S-1. The Commission's Regulation S-X prescribes the form and content for the required financial statements. The comments which follow are intended to supplement such requirements and are illustrative of disclosures set forth in registration statements which have become effective. The Committee on Stockbrokerage Accounting and Auditing of the American Institute of Certified Public Accountants is currently considering an audit guide for broker-dealers in securities, among other things. These comments below will be reconsidered at the time such guide is promulgated.

### (a) Revenues and Expenses

Principal sources of revenues should be shown separately.  
For example:

- Brokerage Commissions
- Principal Transactions
  - Dealer Inventory Profits (Losses)
  - Investment Gains (Losses)
- Underwriting or Investment Banking
- Interest
- Dividends
- Fees from Advisory Services

The composition of significant revenue sources should be detailed in notes to the summary of operations or in tabulations in the text of the prospectus to which reference is made.

Significant categories of expense also should be set forth separately.

### (b) Accounting for Portfolio Securities

- (1) Some registrants account for investment securities on the basis of cost. Others use the basis of market or fair value.

If investment securities are carried at cost for financial reporting purposes, the net change in the difference between (a) cost and (b) market or estimated fair value of investment account securities should be stated in dollars for each reported period immediately following "Net income (loss)." Per share disclosure should include:

- (A) Net income;
- (B) Net change in difference between cost and market or estimated fair value of investment securities; and
- (C) Net income plus (minus) such change.

Differences between cost and market or estimated fair value should be set forth for each reported period in a note. The following information should be presented separately for marketable and non-marketable securities.

- (A) Cost;
- (B) Estimated fair value (non-marketable securities);
- (C) Market value (marketable securities);
- (D) Difference between cost and market or estimated fair value (net of taxes); and
- (E) Net increase (decrease) in difference between cost and estimated fair or market value (net of taxes).

If market or fair value is used for financial reporting purposes, the increase or decrease in net unrealized appreciation or depreciation in investment securities included in results of operations should be disclosed for each reported period in a footnote. The aggregate effect on reported net income (net of taxes) should be shown in dollars and on a per share basis for each period.

- (2) The basis used to value each classification of securities should be stated on the face of the balance sheet or in a note cross referenced to the balance sheet line item. Security positions (both long and short) held in the trading and investment accounts should be further identified by tabulations in supporting notes which show amounts represented by corporate stocks, bonds, government securities, etc. Complementary cost or market or fair value should be disclosed both as to each security category included in the balance sheet (where the aggregate amount is shown parenthetically for each security line item) and for the various classifications detailed in the related notes to the financial statements.

The identity, cost basis and market or fair value should be disclosed separately in a note to the financial statements with respect to the investment in each individual security which exceeds 5% of the balance sheet item in which it is included. Similar disclosure should be furnished in Schedule I (Rule 12-02 of Regulation S-X) with respect to all investment account securities and any trading account securities included in the balance sheet and unsold 30 days thereafter. Appropriate indication is made in Schedule I with respect to any individual security included therein and valued in the financial statements on a basis other than market value.

(c) Stock Exchange Memberships

Market value of stock exchange memberships owned should be disclosed parenthetically in the balance sheet. Memberships contributed under subordination agreements should be stated in the balance sheet on the basis of market value.

(d) Customers' Margin and Commodity Accounts

Amounts receivable from customers with respect to margin and commodity accounts should be disclosed and the value of related collateral held should be stated.

(e) Net Capital

The term "net capital" should be explained in a note to the financial statements or cross referenced to a textual explanation. It should be indicated whether the broker-dealer was in compliance with applicable net capital requirements as of the date of the latest balance sheet. For financial statement purposes, subordinated indebtedness in the form of specific securities which must be returned at maturity of the indebtedness should be valued at balance sheet date market value.

(f) Transaction Balances with Other Broker-Dealers

The composition of accounts receivable/payable from/to brokers and dealers should be detailed in the balance sheet or in a note to which reference is made. "Securities Failed to Deliver" and "Securities Failed to Receive" included in such balances should be further described to distinguish between amounts due less than 30 days and amounts due 30 days or more. If transactions are booked by trade date, securities sold and not yet delivered and securities bought and not yet received should be classified as amounts due for settlement and amounts not due for settlement.

(g) Subordination Arrangements

Subordinated borrowings should be set forth under separate captions in the balance sheet. For financial statement purposes, liabilities under subordination agreements should not be included as an element of capital. If the composition of subordinated borrowings is not apparent from the balance sheet, a note should be added to describe the assets subject to subordination agreements, the related debt and any restrictions attaching to the general use of the assets borrowed under the agreements.

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Current Financial Statements and Related Data

The relatively high turnover of liquid assets of broker-dealers and the relationship of revenues and profits to levels of activity and prices in the securities markets require that the most current information available be disclosed. Broker-dealers are subject to stringent record-keeping requirements and should have current information readily available. Accordingly, broker-dealers should be prepared to furnish financial statements and related data compared with a similar period of the preceding year, so that the registration statement, when it becomes effective will include data no more than 75 days old. In ordinary circumstances such updated financial statements need not be certified.

### 3. Explanation of Operating Results

In view of certain features of broker-dealer operations not necessarily shared by other issuers, textual comment with respect to the results of operations in the following areas is appropriate.

- (a) Material trends in revenues, profits (losses) and operating margins should be explained. To assure a fair understanding of the quality of the earnings stream, individual transactions which have a significant effect upon reported income (loss) for any fiscal period should be separately disclosed.
- (b) The amount of customers' free credit balances should be disclosed and aggregate and per share effects upon net income (loss) of material savings in bank borrowings and related interest expense obtained through the use of such free credit balances should be included. Pending administrative proposals that may affect the availability of such balances in the future should be indicated.
- (c) The effect which proposed regulatory changes or changes adopted subsequent to the dates of the financial statements may have upon a broker-dealer's financial condition and operating results should be disclosed. For example, the effects of changes in commission rate schedules, introduction of negotiated commission rates and changes in regulations with respect to the segregation of customers' securities and cash balances should be explained.

### 4. Net Capital Disclosure

The important effects which present and proposed net capital requirements of the Commission or national stock exchanges may have upon a broker-dealer's ability to conduct business operations should be disclosed in the forepart of the prospectus. Often, it is appropriate to include this disclosure in connection with the "Use of Proceeds" or "Capitalization" sections. The details of required net capital disclosure will depend upon the nature of a broker-dealer's business activities and the difficulties which the broker-dealer has encountered in complying with net capital requirements in the past. The disclosure format set forth in Appendix A was used in several recent prospectuses.

Additional disclosure should indicate whether at all times within the last three years the broker-dealer was in compliance with net capital requirements and any more stringent regulatory guidelines. If not, the time(s) when the broker-dealer was not in compliance and the ratio of indebtedness to net capital at such time(s) should be disclosed. Any internal policies with respect to net capital also should be indicated.

Broker-dealers using subordination arrangements as a means of raising capital should disclose the nature and extent of such arrangements including the costs and high risks inherent therein.

Where appropriate, broker-dealers should disclose their pro forma net capital ratios as of the most recent practicable date giving effect to the application of proceeds from the public offering.

#### 5. Description of Business

The prospectus of a broker-dealer should describe the business done and intended to be done by the broker-dealer and any subsidiaries and the general development of such business during the past five years or such shorter period as the broker-dealer may have been engaged in business. (See e. g., Item 9(a) of Form S-1.) Statistical information presented in tabular format is useful for the above purpose. Material components of each principal source of revenues indicated in the broker-dealer's statement of operations or summary of earnings should be disclosed for each period covered by the summary of earnings. For example: Commission revenues may be broken down by type of customer, type of security, and type of market place; trading profits (losses) may be broken down by type of activity, type of security and type of market place; and underwriting revenues may be broken down by type of security. The relative importance of "retail" and "institutional" business should be disclosed. An explanation of any material trends in these statistics should be set forth.

To the extent applicable, disclosures such as those called for by Items 9(b) and (c) of Form S-1 should be furnished.

Required statistical and other disclosures will depend upon their materiality to the particular business of each broker-dealer. The following types of disclosures have been included in various broker-dealer registration statements which have become effective.

##### (a) Commission Business

- (1) Number of registered representatives.
- (2) Number of active accounts.
- (3) Number of transactions.

The tabular information should reflect increases or decreases in commission business as well as turnover of accounts. Where practicable, information also should be provided as to the average size commission order and average commission revenue per transaction.

**Material expenditures for advertising or development of business should be disclosed.**

The company's policy regarding the handling of small transactions should be disclosed. Any policies limiting the type of transactions handled should be **set forth**.

(b) Trading Activities

- (1) Number of traders classified by type of securities traded.
- (2) Number of securities in which the registrant makes a market.
- (3) Number of transactions.
- (4) Dollar amount of highest, lowest, and average inventory of securities (by class) for the most recent fiscal period.

The extent to which trading activities involve transactions with "retail" customers, block trading or block positioning, market making, or other trading activities should be indicated. Criteria used in determining securities traded, market place, commission or spread, inventory carried, and other transactional guidelines should be disclosed.

(c) Underwriting Activities

- (1) Furnish a tabulation for each period covered by the summary of earnings of the number and dollar amount of underwritings in which the issuer was: (A) manager or co-manager and (B) syndicate member. The table should be broken down by class of securities. If the aggregate dollar amounts of the underwritings are stated, the dollar amounts of the issuer's actual participation also should be stated. Any sales made as a dealer should be indicated.
- (2) Mutual fund sales activities should be disclosed separately and broken down as to sales of independent funds and sales of funds sponsored by affiliates of the broker-dealer. Information also should be disclosed as to the dollar amount of brokerage commissions received from mutual funds which may be deemed directed or reciprocal business. Any material arrangements with individual funds should be disclosed separately. The number of mutual fund salesmen employed should be indicated.



(d) **Research Activities**

Indicate briefly the nature and importance of any research activities including the number of research personnel and their experience. Furnish information as to the number and type of research reports issued and the type of customers receiving these reports. Disclose any fees or commissions received for research. Describe any restrictions on the availability of reports to all customers.

(e) **Investment Advisory and Investment Management Activities**

Describe the terms of any material investment advisory and management agreements. Disclose brokerage commissions derived from advisory and management activities. Furnish tabular information as to the market value of assets and number of accounts under management.

In addition, prospectuses should disclose policies with respect to arbitrage transactions, option writing, commodities transactions, receipt of securities or other considerations in connection with underwriting activities, investments in or sales of real estate or other investment media, investments in restricted securities, investments in controlling interests in other companies and transactions in the broker-dealer's securities. The nature and extent of any of these activities which are material should be described.

The description of business should be presented in a manner which explains the relative capital and other risks in various transactions. For example, if a broker-dealer engages in firm commitment underwriting, block positioning, or the financing of customer purchases on margin, the mechanics of these transactions should be explained.

6. Branch Offices

Broker-dealers that conduct operations through branch offices should disclose for each fiscal period covered by the summary of earnings, the number of branches opened, closed, and in operation at the end of the period. Geographical distribution of branches also should be indicated. Policies with respect to opening, closing and maintaining branches should be discussed. Average experience with start up costs for new branches should be indicated. Information should be provided as to any unprofitable branches and plans with respect thereto.

### 7. Competition

Competition in each material activity should be discussed separately. If objective criteria are available, the broker-dealer's competitive rank or position should be indicated.

Size, financial strength, and efficiency should be discussed as factors that affect competition within the securities industry. Other factors which may affect the competitive structure of the securities industry should be disclosed where applicable. For example, access of financial institutions and broker-dealers to various market places, impact of NASDAQ and other automated quotation systems, revision of commission rate structures, trends toward public ownership, antitrust implications of present industry practices, and pending proposals for industry change, should be considered.

### 8. Personnel

Information should be furnished as to the number of sales, supervisory and administrative employees. Policies with respect to training, supervising and compensating different classes of employees should be disclosed. Any material turnover of personnel should be indicated.

### 9. Administration and Support Activities

The necessity, from a profit and a regulatory standpoint, of keeping current and accurate books and records should be emphasized. Information should be furnished as to the adequacy and efficiency of the company's personnel, equipment and office facilities for purposes of processing customers' orders, handling securities transfers, record keeping and other support functions. The degree of automation within the firm should be indicated.

A description of the broker-dealer's method of processing transactions including an explanation of any problems experienced therein should be furnished. The nature of this disclosure will depend upon the circumstances. In some cases, the status of certain operational statistics such as "fails" and certain accounts such as "suspense" and "difference" accounts may be appropriate. The disclosure format set forth in Appendix B was used in several recent prospectuses.

If the company is a member of any industry or self-regulatory organization's reporting system for purposes of comparing operational statistics, disclosure of company performance compared to the average of its competitors may be required.

If clearance or settlement functions are carried out through the facilities of another organization, the terms of such arrangements and the adequacy thereof should be disclosed.

If applicable and material, information on the following subjects should be disclosed:

- (a) The existence and size of dividends payable and dividends receivable including debit, credit, long and short values, and ages thereof;
- (b) the currency and accuracy of the posting of the company's records;
- (c) the volume of transactions processed;
- (d) the amount, nature, trend, and significance of customer complaints;
- (e) the adequacy of bonding, and other insurance and employee security measures;
- (f) the nature and content of any reports required to be filed with government or self-regulatory authorities beyond those reports normally required; and
- (g) any voluntary limitations on business or any sanctions imposed by government or self-regulatory authorities including the reasons therefor and the results thereof.

#### 10. Regulation

The principal provisions of federal and state statutes under which the broker-dealer and its personnel are permitted to conduct business should be disclosed briefly. The extent to which these statutes authorize regulatory bodies to impose fines or suspend or revoke the broker-dealer's permission to do business should be emphasized. Similar information should be furnished as to principal requirements of self-regulatory organizations of which the broker-dealer is a member.

Disclosure should be made of any fines, suspensions, or other sanctions imposed upon the broker-dealer or its present personnel by governmental or self-regulatory organizations within the past ten years.

Other provisions which may materially affect the conduct of the broker-dealer's business should be disclosed. For example, potential liability for underwriting activities under the Securities Act of 1933, the effect of NASD guidelines with respect to just and equitable principles of trade, the effect of the 1970 amendments to the Investment Company Act of 1940 and related authority granted to the NASD, and obligations under the Securities Investor Protection Act of 1970, should be indicated.

Pending proposals for regulatory or industry change which may materially affect the broker-dealer's operations also should be discussed.

11. Public Offering and Public Ownership  
Standards of Self-Regulatory Organizations

The National Association of Securities Dealers (NASD) and several national stock exchanges have either proposed or adopted standards relating to public offerings and public ownership of securities of member broker-dealers. These standards include substantive as well as procedural requirements. To the extent that these standards are material for an informed investment decision with respect to the broker-dealer's securities, they should be disclosed in appropriate sections of the prospectus. For example, underwriting standards for public offerings should be disclosed under "Underwriting" or "Plan of Distribution." Limitations on the nature and amount of public ownership should be disclosed under "Regulation" or "Description of Securities."

Persons responsible for the preparation of broker-dealer public offerings should familiarize themselves with the aforementioned self-regulatory standards. Issuers should be in a position to advise the Commission before the proposed public offering date whether the terms of the offering have been objected to by any self-regulatory organization.

By the Commission.

Ronald F. Hunt  
Secretary

**NOTICE**

In corresponding with the Commission about mailing list changes and delisting, please include ALL MAILING LIST CODES AND SYMBOLS appearing in your address as presently shown.

APPENDIX A

The company as a member of the NYSE is subject to the net capital rule (NYSE Rule 325) adopted and administered by that national securities exchange. This net capital rule prohibits a broker-dealer from engaging in any securities transaction at a time when its "aggregate indebtedness" exceeds fifteen (15) times its "net capital" as those terms are defined by this rule. This net capital rule requires not only that a firm be solvent in that its assets must exceed its liabilities, but also that at least a minimum part of its assets (amounting to not less than 1/15th (6-2/3%) of its aggregate indebtedness) be kept in cash or highly liquid form. In computing net capital various adjustments are made with a view to excluding assets which are not readily convertible into cash and with a view to a conservative statement of the other assets such as a firm's position in securities. To that end, a deduction is made against the market value of securities to reflect the possibility of a market decline prior to their disposition. For every dollar that net capital is reduced, by means of such deductions or otherwise (for example, through operating losses or capital distributions) the aggregate indebtedness which the firm may carry is correspondingly reduced by fifteen dollars. Thus, the net capital rule, which is unique to the securities industry, imposes financial restrictions upon the company which are more severe than those imposed on other types of businesses. Compliance with this rule may limit the extent of the company's operations which require the intensive use of its capital, such as underwriting securities distributions and maintaining the inventory required for firm trading in securities. Furthermore, compliance with this rule may limit or even preclude the company's ability to pay dividends to its shareholders.

The NYSE, as a matter of policy, may require a member firm to reduce its business if its net capital ratio exceeds 12 to 1 and it may prohibit a member firm from expanding its business if its net capital ratio exceeds 10 to 1.

At March 31, 1971, the company's aggregate indebtedness and net capital (as previously defined) were \$ \_\_\_\_\_ and \$ \_\_\_\_\_ and its net capital ratio was \_\_\_\_\_ to 1 (\_\_\_\_%). At June 30, 1971 its aggregate indebtedness and net capital were \$ \_\_\_\_\_ and \$ \_\_\_\_\_ and its net capital ratio was \_\_\_\_\_ to 1 (\_\_\_\_%).

APPENDIX B

Fails are a meaningful measure of a firm's operational capacity because they provide an indication of the ability of a broker to transfer certificates, make and receive payment, and realize income. A "fail to deliver" is an account receivable from another broker to whom securities have been sold; it occurs when the broker is unable to deliver on settlement date the securities it has sold. A "fail to receive" is an account payable or liability to another broker from whom securities have been purchased; it occurs when the other broker is unable to deliver on settlement date the securities it has sold.

[Furnish the following statistics. Where appropriate, New York City and out-of-town fails may be shown separately.]

Fails to Deliver

<u>current</u>		<u>aged (over 30 days)</u>	
item	dollar value	item	dollar value
_____	_____	_____	_____

Fails to Receive

<u>current</u>		<u>aged (over 30 days)</u>	
item	dollar value	item	dollar value
_____	_____	_____	_____

Fails as days of trading \_\_\_\_\_ (last month)

Fails as percent of net worth \_\_\_\_\_ (last month)

Ratio of fails to deliver to fails to receive \_\_\_\_\_ (last month)

[Include a brief statement of the company's fails related to industry-wide fails. (last month).]

[Explain the term "buys ins" and disclose the number of trades the company was bought in during the preceding month and the number of trades the company bought in during the preceding month.]

Another measure of the company's ability to solve its operational problems is the use of suspense accounts and difference accounts. A suspense account is a temporary holding account used to record securities and/or funds which cannot be immediately identified and cleared. Such accounts exist until such identities can be resolved. A difference account is an account set up when reconciliation between two accounts cannot be made. These differences may arise from variances between: (a) control and subsidiary accounts; (b) records maintained by the company and an actual physical count of the securities in such accounts; and (c) records of the company and records of other firms dealing with the company.

[Describe separately any suspense and difference accounts in terms of items, dollar value, age, net worth and net capital, progress towards resolution and frequency of use.]

For RELEASE Tuesday, November 30, 1971

SECURITIES AND EXCHANGE COMMISSION  
Washington, D. C. 20549

SECURITIES ACT OF 1933  
Release No. 5211

SECURITIES EXCHANGE ACT OF 1934  
Release No. 9387

APPLICABILITY OF THE SECURITIES LAWS TO MULTI-  
LEVEL DISTRIBUTORSHIP AND PYRAMID SALES PLANS

The Securities and Exchange Commission has considered the applicability of the securities laws to multi-level distributorship and other business opportunities that are being offered to prospective participants through pyramid sales plans. The Commission believes that the operation of such plans often involves the offering of an "investment contract" or a "participation in a profit sharing agreement," which are securities within the meaning of Section 2(1) of the Securities Act of 1933. In such cases the security involved--the agreement between the offering company and the investor--must be registered with the Commission unless an exemption is available. In the absence of registration or an exemption, sales of these securities violate Section 5 of the Securities Act.

Moreover, any person who participates in the distribution of these securities may be a broker as defined in Section 3(a)(4) of the Securities Exchange Act of 1934 and, unless an exemption is available, would be required to register as such pursuant to Section 15(a)(1) of that Act. For example, this might include, among others, persons who, for a finder's fee, commission, bonus or other compensation, induce others to become participants in the plans for the purpose of recruiting still other participants.

In addition, where deceptive acts and practices are committed in connection with the offer or sale of these securities, those responsible violate the antifraud provisions of Section 17(a) of the Securities Act and Sections 10(b) and 15(c)(1) of the Securities Exchange Act and Rules 10b-5 and 15c1-2 under that Act.

The common element of the various forms of pyramid promotions is a sales pitch which stresses the amount of money a participant can make on the recruitment of others to participate in the plan. This may serve to obscure the nature of the basic relationship being created between participants in the plan and the offering company. A discussion of two of the more prominent forms of promotions follows. The description of these programs should not be taken to indicate that promotions taking different forms may not also be within the purview of the following discussion.

In the typical form of multi-level distributorship that has been established through pyramid promotions, the company represents that it intends to manufacture, or to sell under its own trade name, a line of products and it purports to be offering franchises for the distribution of those products which appear to follow established forms of franchise-distributorships. Normally several types of distributorship agreements are said to be available to the public which are described more or less as follows. At the lowest level for a relatively small fee the participant is provided with a sample inventory and will be authorized



only to make retail sales to the public. For a larger fee, the participant is supposed to receive a wholesale inventory that he in turn supplies to salesmen whom he supervises. This participant may also be authorized to make retail sales of his own. For an even larger fee, a more substantial wholesale inventory is obtained and responsibility is assumed for supervision of lower-level participants. At the highest level of distribution, for a very substantial fee, a purported right to be the link between the company and the distribution chain is acquired. If the distribution program should actually go into effect, under such plans, in accordance with a predetermined schedule, each distributor would pay less for products to those from whom he gets them than he would receive when he passes the products on through distribution channels to the consumer. Where in these circumstances prospective participants are led to believe that they may profit from participation in these distribution programs without actually assuming the significant functional responsibilities that normally attend the operation of a franchise, in the Commission's opinion there is the offer of a security. Even where a specific offer is not made, if in the actual operation of a distributor-ship program profits are shared with or other forms of remuneration are given to persons who have provided funds to the enterprise--purportedly for a franchise or other form of license--but those persons do not in fact perform the functions of a franchisee, there would appear to be an investment contract.

It must be emphasized that the assignment of nominal or limited responsibilities to the participant does not negative the existence of an investment contract; where the duties assigned are so narrowly circumscribed as to involve little real choice of action or where the duties assigned would in any event have little direct effect upon receipt by the participant of the benefits promised by the promoters, a security may be found to exist. As the Supreme Court has held, emphasis must be placed upon economic reality. See Securities and Exchange Commission v. W. J. Howey Co., 328 U.S. 293 (1946). While the Commission has not taken the position that a franchise arrangement necessarily involves the offer and sale of a security, in the Commission's view a security is offered or sold where the franchisee is not required to make significant efforts in the operation of the franchise in order to obtain the promised return.

A different program that has frequently employed a pyramid sales promotion involves the solicitation of capital from a limited number of "founders" to construct a local retail store that will be owned and operated by the promoters. Under these plans the "founders" typically make a payment of money to the promoters (which may nominally involve the purchase of some product) and the "founders" are provided with some form of identification card that they are required to distribute to prospective customers of the store in advance of the store's opening. Once the store is in operation the "founder" is to receive a "commission" on sales made to those persons having the identification cards that the "founder" has provided. In the Commission's view, these programs involve the offer and sale of investment contracts. The basic promotional efforts that "founders" are required to make in advance of the store's opening--distribution of cards to prospective customers--even if required to continue after the store's opening, do not involve the kind or degree of participation in the management of an enterprise that might negate the inference of an investment relationship.

In Securities and Exchange Commission v. C. M. Joiner Leasing Corp., 320 U.S. 344, 351 (1943), the Supreme Court observed that the nature of securities that are subject to the federal securities laws does not stop with the obvious and commonplace: "Novel, uncommon, or irregular devices, whatever they appear to be, are also reached if it be proved as matter of fact that they were widely

offered or dealt in under terms or courses of dealing which established their character in commerce as 'investment contracts,' or as 'any interest or instrument commonly known as a "security"'. Similarly in Securities and Exchange Commission v. W. J. Howey Co., 328 U.S. 293, 301 (1946) the Court described the purported sales of orange groves as a kind of investment contract. In that context it stated: "The test is whether the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others." It has been contended that, since it is an element of some promotions of the kind here considered that the prospective investor must make some efforts himself, the contracts do not fall within that definition. But in the Commission's view a failure to consider the kind and degree of efforts required of the investors ignores the equally significant teachings of Howey, id. at 299, that form is to be disregarded for substance and that the investment-contract concept

"embodies a flexible rather than a static principle, one that is capable of adaptation to meet the countless and variable schemes devised by those who seek the use of the money of others on the promise of profits."

These words compel the conclusion that the Howey decision itself may not be permitted to become a "static principle" easily avoided by ingeniously-devised variations in form from the particular type of investment relationship described in that case.

The term "security" must be defined in a manner adequate to serve the purpose of protecting investors. The existence of a security must depend in significant measure upon the degree of managerial authority over the investor's funds retained or given; and performance by an investor of duties related to the enterprise, even if financially significant and plainly contributing to the success of the venture, may be irrelevant to the existence of a security if the investor does not control the use of his funds to a significant degree. The "efforts of others" referred to in Howey are limited, therefore, to those types of essential managerial efforts but for which the anticipated return could not be produced.

Nor is it significant that the return promised for the use of an investor's money may be something other than a share of the profits of the enterprise. The Court in Howey described an investment contract providing the investor with an equity interest in the common enterprise; where the interest offered is of a different nature the promised return will necessarily vary. Thus, for example, market-price appreciation in value--not profits in a commercial sense--was significant in the investment contracts recognized by the Supreme Court in Securities and Exchange Commission v. Variable Annuity Life Ins. Co., 359 U.S. 65 (1959) and Securities and Exchange Commission v. United Benefit, 387 U.S. 202 (1967). The expectation of "commissions" for the use of investor's money, when not linked to services of the kind or degree for which commissions are normally paid in non-investment contexts, is also consistent with the existence of an investment contract.

In a recent decision, the Supreme Court of Hawaii has considered the meaning of the term "investment contract" as used in a state-statute definition of the term "security" that is substantially similar to the definitions contained in the federal securities laws. State v. Hawaii Market Center, Inc., 485 P.2d 105 (1971). The Hawaii Market Center through a pyramid promotion had offered participation in a retail-store enterprise of the kind described above. While embracing interpretive principles of the kind laid down by the United States Supreme Court in Howey and Joiner, the Hawaii court rejected

a literal adherence to the language that the Supreme Court found appropriate in describing the specific type of investment contract that was before it in Howey, where profits were, indeed, to come "solely from the efforts" of others. In doing so, that court noted the danger that "courts [might] become entrapped in polemics over the meaning of the word 'solely' and fail to consider the more fundamental question whether the statutory policy of affording broad protection to investors should be applied even to those situations where an investor is not inactive, but participates to a limited degree in the operation of the business." Id. at 108 (footnote omitted). For purposes of the Hawaii Securities Act, therefore, the court held (id. at 109) that an investment contract exists where:

- "(1) An offeree furnishes initial value to an offeror, and
- "(2) a portion of this initial value is subjected to the risks of the enterprise, and
- "(3) the furnishing of the initial value is induced by the offeror's promises or representations which give rise to a reasonable understanding that a valuable benefit of some kind, over and above the initial value, will accrue to the offeree as a result of the operation of the enterprise, and
- "(4) the offeree does not receive the right to exercise practical and actual control over the managerial decisions of the enterprise."

The Commission believes that the court's analysis of the investment-contract concept in the Hawaii Market Center case is equally applicable under the federal securities laws. While the conclusion of the Hawaii court encompasses types of investment contracts that the Supreme Court of the United States has not yet specifically considered, the Commission believes that its conclusion is fully consistent with the remedial approach repeatedly stated by the Supreme Court to be appropriate in interpreting the federal securities laws. See Tcherepnin v. Knight, 389 U.S. 322 (1967) (Securities Exchange Act); Securities and Exchange Commission v. Capital Gains Research Bureau, 375 U.S. 180 (1963) (Investment Company Act); Securities and Exchange Commission v. W. J. Howey Co., 328 U.S. 293 (1946) (Securities Act); Securities and Exchange Commission v. C. M. Joiner Leasing Corp., 320 U.S. 344 (1943) (Securities Act).

It further appears to the Commission that the pyramid sales promotions that are often employed in connection with the sale of securities of the types described above may be inherently fraudulent. Under these programs, various cash fees and percentage incentives are offered to those willing to participate as an inducement for the recruitment of additional participants. This aspect of the promotion is often given great emphasis at "opportunity meetings" at which movies may be shown and speeches made concentrating on the allegedly unlimited potential to make money in a relatively short period of time by recruiting others into the program. Since there are a finite number of prospective participants in any area, however, those induced to participate at later stages have little or no opportunity for recruitment of further persons. It is patently fraudulent to fail to disclose these factors to prospective investors. Even where some disclosure of these practicalities is made, moreover, it may be made in a manner that misleadingly fails to note the significance to the participants of the facts disclosed. In the Commission's view, use of this inherently fraudulent device to induce investment in any enterprise offering securities to the public is a violation of the antifraud provisions of the securities laws.

FOR RELEASE Friday, January 14, 1972

SECURITIES AND EXCHANGE COMMISSION  
Washington, D. C. 20549

Securities Exchange Act of 1934  
Release No. 9459

S.E.C. CAUTIONS BROKER-DEALERS ON SALES  
OF U.S. GOVERNMENT SECURITIES

Information coming to the attention of the Commission indicates that a limited number of broker-dealers have, as a matter of practice, not effected purchase orders of their customers for securities issued by the United States Government. These firms, who were not authorized dealers in Government securities, accepted purchase orders for such securities from their customers but did not fill them. Instead, the securities were "sold short" by the firms to their customers. No effort was made to effect covering purchases in the market or to borrow the securities for delivery to the customer or for segregation at the firms. Although confirmation slips indicated that the firms were acting as principal, they did not reveal that sales were "short" sales and that no security was (or was to be) purchased in actual fact.

Evidence developed by the Commission's Division of Trading and Markets indicates that seven firms were involved from time to time between August 1968 and February 1971, of which six were members of the New York Stock Exchange. The firms defended their actions on the grounds that no customer had suffered financial loss and that they were thereby able to pay certain customers interest on free credit balances while avoiding the expense and operational problems associated with the actual execution of transactions and the custody of negotiable securities. All of such firms have ceased to effect transactions in U.S. Government securities in the above described manner.

Upon learning of the above described practice, the New York Stock Exchange issued Member Firm Educational Circular No. 318, pointing out that the practice violates Exchange Rule 402, requiring the segregation of fully-paid securities, and may also violate Rule 436, dealing with the payment of interest to customers, and Rule 440 and Article XIV, Section 3 of the Exchange's Constitution, with respect to fictitious transactions.

In addition to violating Exchange rules, the transactions involved the fraud of "bucketing" and thus violated Section 17(a) of the Securities Act of 1933 and Sections 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder. Customers' purchase money was utilized without their knowledge or consent as working capital by the firms, and the account statements sent to customers gave them the false impression that the firm had purchased and was holding in safekeeping their securities. Investors

who placed orders for U.S. Government securities obviously were attracted by the safety of an investment in such securities, whereas, as the result of the broker-dealers' practice of short selling such securities, they were in reality making unsecured loans to their firms. Further, this procedure and course of conduct raises questions under Section 17(a) of the Securities Exchange Act of 1934 and Rule 17a-3 thereunder in that the transactions as recorded on the books of account did not reflect the true nature of the transactions. As these were "fictitious" transactions, the firms made false entries in the books and records required to be maintained by this rule and failed to keep same current and accurate.

By Exchange Act Release No. 6778 dated April 16, 1962 the Commission warned broker-dealers that:

"The courts and the Commission have consistently held that a dealer impliedly represents that he will deal fairly with the public, and that this implied representation of firm dealing includes an implied representation that the transaction will be consummated promptly unless there is a clear understanding to the contrary.

\* \* \*

Dealers who sell securities to customers should exercise diligence to deliver the securities promptly, and if they have any reason to believe they will be unable to deliver promptly, they should disclose to the customer all material facts with respect thereto before the transaction is entered into."

This release is being published specifically to caution broker-dealers against the practice of selling U.S. Government securities or any other securities short to their customers, unless: (a) such sales are promptly covered or the appropriate securities are promptly borrowed for segregation or delivery to customers; (b) there is proper recordation of the transactions on the broker's books; and (c) customers are fully and fairly advised of the nature of the transactions.

For RELEASE Wednesday, November 24, 1971

SECURITIES AND EXCHANGE COMMISSION  
Washington, D. C. 20549

SECURITIES EXCHANGE ACT OF 1934  
Release No. 9395

Interpretation of Rule 10b-13 - Payment of  
Solicitation Fees in Tender Offers

The Commission has received a number of inquiries from broker-dealers regarding the circumstances in which a broker-dealer may receive a "soliciting dealer's fee" from a person making a tender offer. Specifically, questions have arisen as to whether an arbitrageur who purchases securities which are the subject of a tender offer in the open market and subsequently tenders such shares may sign a soliciting dealer's agreement and receive a soliciting dealer's fee for the tender of such shares.

Arbitrageurs in a tender offer typically make money on the differential between the market price at the time the tender offer is announced and the tender price, which normally includes a premium above market. Their purchases enable the public investor to elect to avoid the risk that the tender will not be consummated or that it will be prorated. The receipt of a soliciting dealer's fee by an arbitrageur enables him to enhance his profit by tendering his shares at the tender price plus the soliciting dealer's fee. 1/

The language of Rule 10b-13 under the Securities Exchange Act of 1934 prohibits a person making a tender offer from, directly or indirectly, purchasing or making any arrangement to purchase the securities which are the subject of the tender offer otherwise than pursuant to the tender offer. The intent of this language is to protect public investors who, if the tender offer were prorated, might lose the opportunity to tender all their shares whereas those whose shares were purchased outside the tender offer would not be prorated. In view of that intent, the Commission views purchases and subsequent tenders by arbitrageurs, accompanied by receipt of a soliciting dealer's fee, as permissible activities, provided that the payment of such soliciting dealer's fees is adequately disclosed in the context of the tender offer.

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1/ The anticipation of receipt of the soliciting dealer's fee may induce the arbitrageur to purchase the stock to be tendered at prices up to, and possibly even in excess of, the tender price.

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Washington, D. C. 20549

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FOR RELEASE Wednesday, July 7, 1971

SECURITIES AND EXCHANGE COMMISSION  
Washington, D. C.

Securities Act of 1933  
Release No. 5168  
Securities Exchange Act of 1934  
Release No. 9239

SALES OF UNREGISTERED SECURITIES BY BROKER-DEALERS

The Director of the Division of Trading and Markets takes this occasion to reaffirm certain basic standards of conduct required of registered broker-dealers in meeting their responsibilities in connection with sales of significant amounts of unregistered securities.

A number of instances have recently come to the attention of the Division of Trading and Markets in which brokerage firms, including members of national securities exchanges, have failed to meet applicable standards of conduct <sup>1/</sup> in investigating whether sales of securities would result in registration or anti-fraud violations of the federal securities laws. A firm's participation in an unregistered public distribution has frequently been a major factor in the success of this unlawful activity since the firm affords sellers access to the market place and may create an appearance of propriety and substance otherwise lacking. The potential harm to the public is particularly acute when securities of a little-known issuer, or one concerning which reliable information is not readily available, are sold to the public on the over-the-counter market.

The Division is aware of recent instances in which brokerage firms have purported to rely upon opinion letters which fail to describe the facts underlying counsel's conclusion that the shares sold are freely tradeable. Similar reliance has been claimed even when the firm itself had reason to question whether a valid exemption from registration existed. On another occasion, a registered broker-dealer considered the fact that shares were put through transfer to be the definitive test of free transferability. Customers have also occasionally succeeded in selling

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<sup>1/</sup> See, for example, Kennedy Cabot & Co., Inc., Securities Exchange Act Release 8817 (1970); Application of the Securities Act of 1933 and the Securities Exchange Act of 1934 to Spin-Offs of Securities and Trading in the Securities of Inactive or Shell Corporations, Securities Act Release 4982 (1969); Century Securities Co., Securities Exchange Act Release 8123 (1967) Strathmore Securities Inc., Securities Exchange Act Release 8207 (1967); Sutro Brothers & Co. 41 SEC 470 (1963); Distributions by Broker-Dealers of Unregistered Securities, Securities Act Release 4445 (1962); Skiatron Electronics & Television Corp. 40 SEC 236 (1960); S.E.C. v. Culpepper 270 F 2nd 241 (C.A. 2 1959).



substantial amounts of securities in unregistered public distributions because the firm's compliance procedures either did not include scrutiny of sales transactions or were inadequate to detect substantial sales of a particular issue by one or more accounts. Frequently, these sales were made by new customers who opened a brokerage account specifically to effect such unlawful transactions.

As the Commission has stated, 2/

"...[a] dealer who offers to sell, or is asked to sell a substantial amount of securities must take whatever steps are necessary to be sure that this is a transaction not involving an issuer, person in a control relationship with an issuer or an underwriter. For this purpose, it is not sufficient for him merely to accept 'self-serving statements of his sellers and their counsel without reasonably exploring the possibility of contrary facts.' "

The amount of inquiry called for necessarily varies with the circumstances of particular cases. A dealer who is offered a modest amount of a widely traded security by a responsible customer, whose lack of relationship to the issuer is well known to him, may ordinarily proceed with considerable confidence. On the other hand, when a dealer is offered a substantial block of a little-known security, either by persons who appear reluctant to disclose exactly where the securities came from, or where the surrounding circumstances raise a question as to whether or not the ostensible sellers may be merely intermediaries for controlling persons or statutory underwriters, then searching inquiry is called for."

While "the amount of inquiry called for necessarily varies with the circumstances of particular cases," all registered broker-dealers should establish minimum standard procedures to prevent and detect violations

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2/ Distributions by Broker-Dealers of Unregistered Securities, Securities Exchange Act Release No. 6721; Securities Act Release No. 4445 (February 2, 1962), pages 2 and 3, footnote omitted. See also S.E.C. v Culpepper, 270 F. 2d 241 (C.A. 2, 1959) and S.E.C. v Mono-Kearsarge Consolidated Mining Company, 167 F. Supp. 248 (D. Utah, 1958).

of the federal securities laws <sup>3/</sup> and to ensure that the firm meets its continuing responsibility to know both its customers and the securities being sold. There should be written supervisory procedures that cover sales as well as purchases. These must be made known to salesman and be sufficient to reveal promptly to supervisory officials transactions which may, when examined individually or in the aggregate, indicate that sales in a security should be halted immediately pending further inquiry.

Registered broker-dealers should also establish standard procedures as an initial step in their general investigation into the background of prospective customers and the source of the securities to be traded. In the case of a new customer, a new account form identifying the customer and describing his financial condition and investment objectives should be completed before sales are made. A firm should not permit accounts to be opened by third persons or orders accepted from third persons on behalf of a customer without the customer's express authorization. In addition, registered broker-dealers should make certain routine inquiries of customers, including for example; whether the customer has direct or indirect connections with any publicly owned company or with the issuer; what his financial condition is (so that the broker-dealer may determine whether it is consistent with the value of the securities to be sold); whether the customer's securities were acquired on the open market; whether he is the true beneficial owner of them; whether he has non-public information about the issuer and whether he is currently selling or attempting to sell the same securities through other brokerage houses.

Basic information concerning the issuer such as its address, business activities, principals, products, assets, financial condition and number of shares of stock outstanding, should be obtained independently as a matter of course. Where public information concerning the company is not available from the Commission or standard research sources, the extent of inquiry required to reasonably assure the broker or dealer that the proposed transaction complies with applicable legal requirements will be correspondingly greater. Moreover, the Commission has "repeatedly held that it is a violation of the anti-fraud provisions for a broker-dealer to recommend a **security** unless there is an adequate and reasonable basis for the recommendations and, further, that such recommendations should

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<sup>3/</sup> See Rule 15b10-4 under the Securities Exchange Act of 1934, Rules 342 and 405 of the New York Stock Exchange, Rule 411 of the American Stock Exchange and Section 27 of Article III of the Rules of Fair Practice of the National Association of Securities Dealers. Both the Exchange Act and the Investment Advisers Act specifically provide for the imposition of sanctions in any case where a failure to supervise has resulted in violations of the federal securities laws. See also Section 15(b)(5)(E) of the Securities Exchange Act of 1934 and Section 203(e)(5) of the Investment Advisers Act of 1940, effective December 14, 1970.

not be made without disclosure of facts known or reasonably ascertainable, bearing upon the justification for the recommendation." <sup>4/</sup>

The customer's responses or other particular circumstances may reasonably indicate that there is a duty to make further inquiries and verify the information received. The most obvious situations are where a previously unknown customer may be seeking to sell a significant amount of securities and the issuer may be relatively unknown to the public. In this regard, it should be noted that information received from little-known companies or their officials, transfer agent or counsel must be treated with great caution as these are the very parties that may be seeking to deceive the firm. When circumstances suggest that further inquiry and verification by the broker or dealer is necessary, the firm may consider it prudent to document its investigative efforts. The customer could be required, for example, to supply in writing the information suggested above and state that it is accurate and complete. Such a signed statement might not necessarily mean that the information received was inherently more reliable but could supplement the investigatory efforts otherwise required.

Where it appears that securities to be sold were not acquired by open-market purchases, it must be determined whether their sale is exempted from registration under the Securities Act of 1933. Any determination that such an exemption exists should only be made after the broker-dealer has reviewed the facts surrounding the acquisition of the shares and competent outside counsel having no proprietary interest in the offering has furnished a supporting opinion describing the relevant facts in sufficient detail to provide an explicit basis for the legal conclusions stated. <sup>5/</sup> Of course, any firm receiving a sell order where the circumstances raise questions as to the propriety of the transactions should, in the exercise of its responsibilities, immediately alert the nearest Commission office.

Questions concerning the applicability of the Securities Act of 1933 and the Securities Exchange Act of 1934 to the sale of a particular block of securities, together with all of the relevant facts which have been ascertained, should be directed to the U. S. Securities and Exchange Commission, 500 North Capitol Street, Washington, D. C. 20549.

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<sup>4/</sup> See Distribution by Broker-Dealers of Unregistered Securities, Act Release No. 6721 (February 2, 1962) and cases cited therein. Hanley v. S.E.C. 415 F 2nd 589 (C.A. 2, 1969).

<sup>5/</sup> In this regard, the Commission has stated that "if an attorney furnishes an opinion based solely upon hypothetical facts which he has made no effort to verify, and if he knows that his opinion will be relied upon as the basis for a substantial distribution of unregistered securities, a serious question arises as to the propriety of his professional conduct." Securities Exchange Act Release No. 6721; Securities Act Release No. 4445 (February 2, 1962).

For RELEASE Wednesday, October 8, 1969

SECURITIES AND EXCHANGE COMMISSION  
Washington, D. C. 20549

SECURITIES EXCHANGE ACT OF 1934  
Release No. 8712

ADOPTION OF RULE 10b-13 UNDER THE  
SECURITIES EXCHANGE ACT OF 1934

The Securities and Exchange Commission today announced the adoption of Rule 10b-13 under the Securities Exchange Act of 1934 ("the Act") to prohibit a person who makes a cash tender offer or exchange offer for an equity security from purchasing that security (or any other security immediately convertible into or exchangeable for that security) otherwise than pursuant to the tender or exchange offer, during the period beginning with the public announcement or other commencement of the offering, whichever is earlier, and the time when the offer must by its terms be accepted or rejected.

On May 5, 1969, in Securities Exchange Act Release No. 8595, the Commission published its revised proposal to adopt Rule 10b-13. It has considered the comments and suggestions in response to that proposal and now adopts the rule in the form set forth below.

Where securities are purchased for a consideration greater than that of the tender offer price, this operates to the disadvantage of the security holders who have already deposited their securities and who are unable to withdraw them in order to obtain the advantage of possible resulting higher market prices. Additionally, irrespective of the price at which such purchases are made, they are often fraudulent or manipulative in nature and they can deceive the investing public as to the true state of affairs. Their consequences can be various, depending upon conditions in the market and the nature of the purchases. They could defeat the tender offer, either by driving the market price above the offer price or by otherwise reducing the number of shares tendered below the stated minimum. Alternatively, they could further the tender offer by raising the market price to the point where ordinary investors sell in the market to arbitrageurs, who in turn tender. Accordingly, by prohibiting a person who makes a cash tender offer or exchange offer from purchasing equity securities of the same class during the tender offer period otherwise than pursuant to the offer itself, the rule accomplishes the objective of safeguarding the interests of the persons who have tendered their securities in response to a cash tender offer or exchange offer; moreover once the offer has been made, the rule removes any incentive on the part of holders of substantial blocks of securities to demand from the person making a tender offer or exchange offer a consideration greater than or different from that currently offered to public investors.

Although the rule applies to purchases of securities immediately convertible into or exchangeable for securities of the same class which are the subject of the offer, it does not prohibit a person who, at the commencement of the offer, owns securities convertible into or exchangeable for securities of the class which are the subject of the offer from converting or exchanging such holdings into such securities.

The rule deals with purchases or arrangements to purchase, directly or indirectly, which are made from the time of public announcement or initiation of the tender offer or exchange offer, until the person making the offer is required either to accept or reject the tendered securities. As used in the rule an offer could be publicly announced or otherwise made known to the holders of the target security through a published advertisement, a news release, or other communication by or for the person making the offer to holders of the security being sought for cash tender or exchange. Moreover, any understanding or arrangement during the tender offer period, whether or not the terms and conditions thereof have been agreed upon, to make or negotiate such a purchase after the expiration of that period would be prohibited by the rule. Purchases made prior to the inception of that period are not specifically prohibited under the rule, although disclosure of such purchases within a specific prior period is required to be filed in schedules filed under Sections 13(d) and 14(d) of the Act. Of course, the general anti-fraud and anti-manipulation provisions could apply to such pre-tender purchases. The prohibition of Rule 10b-13 applies to exchange offers when publicly announced even though they cannot be made until the happening of a future event, such as the effectiveness of a registration statement under the Securities Act of 1933. As the Commission explained in Securities Exchange Act Release No. 8595, as applied to the offer by one company of its own securities in exchange for the securities of another issuer, the application of Rule 10b-13 to exchange offers in essentially a codification of existing interpretations under Rule 10b-6, which among other things, prohibits a person making a distribution from bidding for or purchasing the security being distributed or any right to acquire that security. These interpretations have pointed out that the security to be acquired in the exchange offer is, in substance, either a right to acquire the security being distributed or is brought within the rule under paragraph (b) thereof; and Rule 10b-6 prohibits the purchase of such security during the distribution except through the exchange offer, unless an exemption is available.

Since Rule 10b-13 applies to a cash tender offer or an offer of an exchange by an issuer to its own security holders of one class of its securities for another, if repurchase of the other security is subject to the prohibitions of Rule 10b-6, the issuer would have to obtain an exemption under paragraph (f) of that rule. Rule 10b-13 does, however, exempt from its prohibitions purchases if otherwise lawful, under specified conditions pursuant to "qualified stock options" or "employee stock purchase plans" as defined in Sections 422 and 423 of the Internal Revenue Code of 1954 as amended, or "restricted stock options" as defined in Section 424(b) of the Internal Revenue Code of 1954 as amended, as well as purchases under specified types of employee plans.

In addition, Rule 10b-13 contains a provision that the Commission may, unconditionally or on terms and conditions, exempt any transaction from the operation of the rule, if the Commission finds that the exemption would not result in the use of a manipulative or deceptive device or contrivance or of a fraudulent, deceptive or manipulative act or practice comprehended within the purpose of the rule. It is contemplated that this exemptive provision would be narrowly construed and that an exemption would be granted by the Commission only in cases involving very special circumstances.

STATUTORY BASIS

The Securities and Exchange Commission acting pursuant to the provisions of the Securities Exchange Act of 1934, and particularly Sections 10(b), 13(e), 14(e) and 23(a) thereof, and deeming it necessary and appropriate in the public interest and for the protection of investors, hereby adopts Rule 10b-13 as set forth below, effective, November 10, 1969.

TEXT OF RULE 10b-13

Rule 10b-13. Prohibiting Other Purchases During Tender Offer or Exchange Offer.

(a) No person who makes a cash tender offer or exchange offer for any equity security shall, directly or indirectly, purchase, or make any arrangement to purchase, any such security (or any other security which is immediately convertible into or exchangeable for such security), otherwise than pursuant to such tender offer or exchange offer, from the time such tender offer or exchange offer is publicly announced or otherwise made known by such person to holders of the security to be acquired until the expiration of the period, including any extensions thereof, during which securities tendered pursuant to such tender offer or exchange offer may by the terms of such offer be accepted or rejected; provided, however, that if such person is the owner of another security which is immediately convertible into or exchangeable for the security which is the subject of the offer, his subsequent exercise of his right of conversion or exchange with respect to such other security shall not be prohibited by this rule.

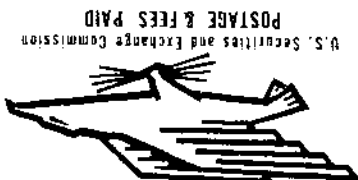
(b) The term "exchange offer" as used in this rule shall include a tender offer for, or request or invitation for tenders of, any security in exchange for any consideration other than for all cash.

(c) The provisions of this rule shall not apply to a purchase of a security of the same class as that which is the subject of a cash tender offer or exchange offer (or of any other security which is immediately convertible into or exchangeable for such security) if such purchase is made by the issuer, by participating employees of the issuer or the employees of its subsidiaries, or by the trustee or other person acquiring such security for the account of such employees, pursuant to (1) a stock option plan involving only "qualified stock options", or qualifying as an "employee stock purchase plan" as those terms are defined in Sections 422 and 423 of the Internal Revenue Code of 1954, as amended, or "restricted stock options" as defined in Section 424(b) of the Internal Revenue Code of 1954, as amended; provided, however, that for the purposes of this paragraph an option which meets all of the conditions of that section other than the date of issuance shall be deemed to be "restricted stock options"; or (2) a savings, investment, pension or other stock purchase plan providing for both (A) periodic payments (or payroll deductions) for acquisition of securities by or on behalf of participating employees and (B) periodic purchases of the securities by participating employees, or the person acquiring them for the account of such employees.

(d) This rule shall not prohibit any transaction or transactions if the Commission, upon written request or upon its own motion, exempts such transaction or transactions, either unconditionally or on specified terms or conditions, as not constituting a manipulative or deceptive device or contrivance or a fraudulent, or deceptive or manipulative act or practice comprehended within the purpose of this rule.

By the Commission.

Orval L. DuBois  
Secretary



UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549  
OFFICIAL BUSINESS  
RETURN AFTER FIVE DAYS

FOR RELEASE Wednesday, July 2, 1969

SECURITIES AND EXCHANGE COMMISSION  
Washington, D. C.

Securities Act of 1933  
Release No. 4982  
Securities Exchange Act of 1934  
Release No. 8638

APPLICATION OF THE SECURITIES ACT OF 1933  
AND THE SECURITIES EXCHANGE ACT OF 1934 TO  
SPIN OFFS OF SECURITIES AND TRADING IN THE  
SECURITIES OF INACTIVE OR SHELL CORPORATIONS

The Securities and Exchange Commission today made publicly known its concern with the methods being employed by a growing number of companies and persons to effect distributions to the public of unregistered securities in possible violation of the registration requirements of the Securities Act of 1933 and of the anti-fraud and anti-manipulative provisions of the Securities Act of 1933 and the Securities Exchange Act of 1934. The methods employed can take and in fact have taken a variety of patterns.

I

Frequently, the pattern involves the issuance by a company, with little, if any, business activity, of its shares to a publicly-owned company in exchange for what may or may not be nominal consideration. The publicly-owned company subsequently spins off the shares to its shareholders with the result that active trading in the shares begins with no information on the issuer being available to the investing public. Despite this lack of information, moreover, the shares frequently trade in an active market at increasingly higher prices. Under such a pattern, when the shares are issued to the publicly-owned or acquiring company, a sale takes place within the meaning of the Securities Act and if the shares are then distributed to the shareholders of the acquiring company, that company may be an underwriter within the meaning of Section 2(11) of the Act as a person "who purchased from an issuer with a view to . . . the distribution of any security" or as a person who "has a direct or indirect participation in any such undertaking."



While the distribution of the shares to the acquiring company's shareholders may not, in itself, constitute a distribution for the purposes of the Act, the entire process, including the re-distribution in the trading market which can be anticipated and which may indeed be a principal purpose of the spin off, can have that consequence. It is accordingly the Commission's position that the shares which are distributed in certain spin offs involve the participation of a statutory underwriter and are thus, in those transactions, subject to the registration requirements of the Act and subsequent transactions in the shares by dealers, unless otherwise exempt, would be subject to the provisions of Section 5 requiring the delivery of a prospectus during the forty or ninety day period set forth in Section 4(3).

The theory has been advanced that since a sale is not involved in the distribution of the shares in a spin off that registration is not required and that even if it is required, no purpose would be served by filing a registration statement and requiring the delivery of a prospectus since the persons receiving the shares are not called upon to make an investment judgment.

This reasoning fails, however, to take into account that there is a sale by the issuer and the distribution thereafter does not cease at the point of receipt by the initial distributees of the shares but continues into the trading market involving sales to the investing public at large. Moreover, it ignores what appears to be primarily the purpose of the spin off in numerous circumstances which is to create quickly, and without the disclosure required by registration, a trading market in the shares of the issuer. Devices of this kind, contravene the purpose, as well as the specific provisions, of the Act which, in the words of the statutory preamble, are "to provide full and fair disclosure of the character of the securities sold in interstate and foreign commerce and through the mails, and to prevent frauds in the sale thereof." In the circumstances of a spin off, when the shares are thereafter traded in the absence of information about the issuer, the potential for fraud and deceit is manifest.

This release does not attempt to deal with any problems attributable to more conventional spin offs, which do not involve a process of purchase of securities by a publicly-owned company followed by their spin off and redistribution in the trading markets.

## II

Another pattern has come to the Commission's attention in which certain promoters have acquired corporations which have ceased active operations, or which have little or no assets ("shell corporations"), and which have a substantial number of shares outstanding, generally in the hands of the public. Thereafter the promoters have engaged in activities to quickly increase the market value of their shareholdings. For example, in some cases promoters have initiated a program

of acquisitions, transferring assets of dubious value to the "shell corporations" in exchange for substantial amounts of newly issued shares. This activity is frequently accompanied by publicity containing exaggerated or misleading statements and designed to stimulate interest of public investors in the company's shares in violation of the anti-fraud provisions of the Securities Exchange Act of 1934. Thereafter the market prices of these securities have risen sharply under circumstances which bear no relationship to the underlying financial condition and business activities of the company. In some of these cases the promoters or other corporate insiders, take advantage of the market activity and the price rise which they have generated, have sold their shares at the inflated prices to the public in violation of the registration and anti-fraud provisions of the Federal securities laws. Similar activities have also been noted in a number of cases involving shares which a publicly held company has spun off to its shareholders.

### III

The activities discussed above generally can only be successfully accomplished through the efforts of brokers and dealers. Accordingly, brokers and dealers are cautioned to be particularly mindful of their obligations under the registration and anti-fraud provisions of the Federal securities laws with respect to effecting transactions in such securities. In this connection, where a broker or dealer receives an order to sell securities of a little-known, inactive issuer, or one with respect to which there is no current information available except possibly unfounded rumors, care must be taken to obtain sufficient information about the issuer and the person desirous of effecting the trade in order to be reasonably assured that the proposed transaction complies with the applicable requirements. Moreover, before a broker or dealer induces or solicits a transaction he should make diligent inquiry concerning the issuer, in order to form a reasonable basis for his recommendation, and fully inform his customers of the information so obtained, or in the absence of any information, of that fact.

In the foregoing connection the Commission also calls attention to its release dated February 2, 1962 on the subject "Distribution by Broker-dealers of Unregistered Securities" (Securities Act Release No. 4445, Securities Exchange Act Release No. 6721).

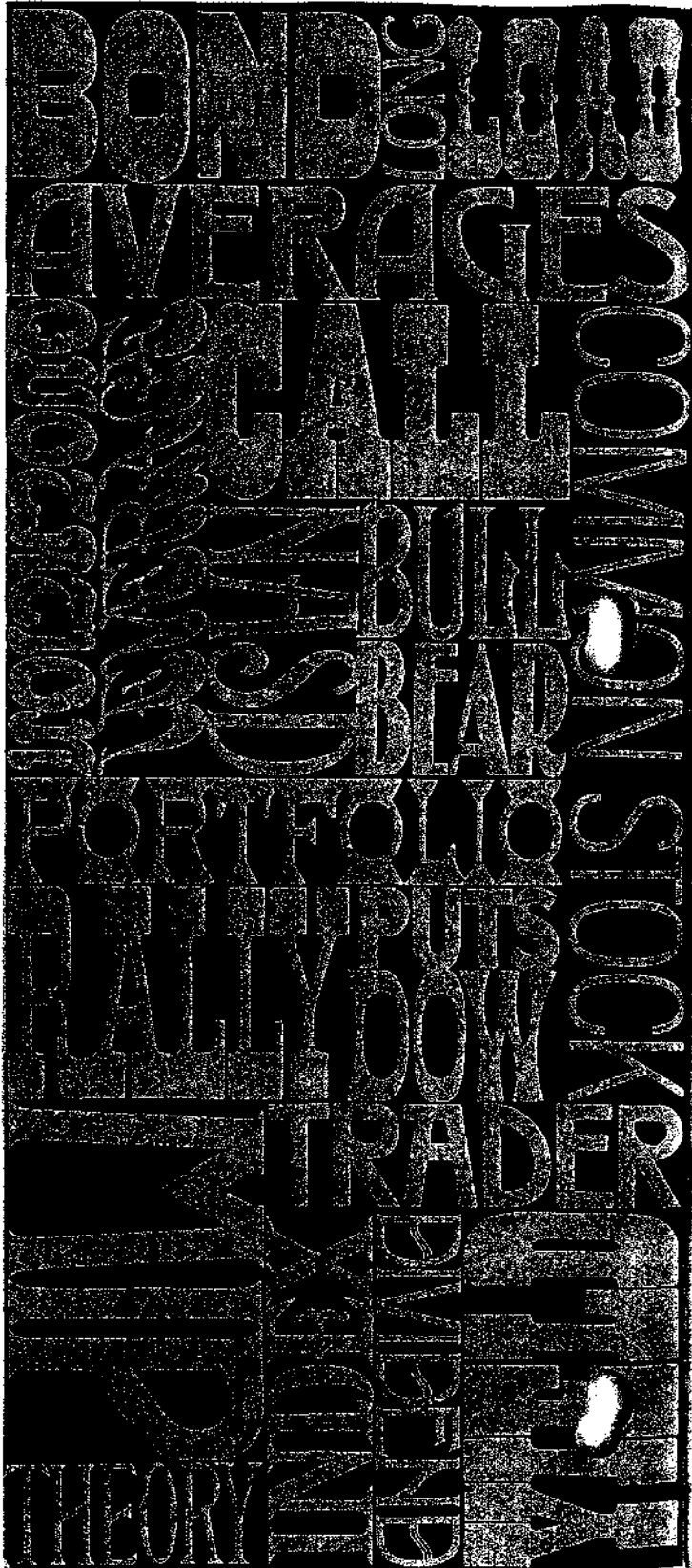
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THE LANGUAGE  
OF INVESTING  
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COMMON STOCK  
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THEORY



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### Introduction

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The language spoken in America's investment world may sound like a strange tongue to the newcomer. It is often vivid, colorful, flavored with the idioms of many eras. Some expressions have filtered down from the day when brokers traded securities under a buttonwood tree in the open air. Others are so new that they have seldom been indexed before.

Any glossary of this special language involves certain problems. Some words and phrases cannot be defined completely without going into related background material—others have nuances of meaning which even the experts may dispute.

We have tried to define terms simply and easily, trimming subtle shades of meaning in the interest of brevity and readability.

New investors, and many seasoned ones, are often puzzled by words and phrases relating to investment—we hope they find this booklet helpful. Investment, after all, is not the province of a few people but the right of men and women everywhere.

Additional information relating to any particular expression may be obtained without obligation from a member firm of the New York Stock Exchange, Inc. or from the Exchange itself.

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Published by the New York Stock Exchange, Inc. with data compiled as of February 1, 1972.

### Accrued Interest

Interest accrued on a bond since the last interest payment was made. The buyer of the bond pays the market price plus accrued interest. Exceptions include bonds that are in default and income bonds. See: *Flat, Income Bond*

### All or None Order

A market or limited price order which is to be executed in its entirety or not at all, but, unlike a fill or kill order, is not to be treated as cancelled if not executed as soon as it is represented in the Trading Crowd. Bids or offers on behalf of all or none orders may not be made in stocks, but may be made in bonds when the number of bonds is fifty or more.

### Alternative Order—Either/Or Order

An order to do either of two alternatives—such as, either sell (buy) a particular stock at a limit price or sell (buy) on stop. If the order is for one unit of trading when one part of the order is executed on the happening of one alternative, the order on the other alternative is treated as cancelled. If the order is for an amount larger than one unit of trading, the number of units executed determines the amount of the alternative order to be treated as cancelled.

### Amortization

A generic term. Includes various specific practices such as depreciation, depletion, write-off of intangibles, prepaid expenses and deferred charges.

### Annual Report

The formal financial statement issued yearly by a corporation to its shareowners. The annual report shows assets, liabilities, earnings—how the company stood at the close of the business year and how it fared profit-wise during the year.

### Arbitrage

A technique employed to take advantage of differences in price. If, for example, XYZ stock can be bought in New York for \$10 a share and sold in London at \$10.50, an arbitrageur may simultaneously purchase XYZ stock here and sell the same amount in London, making a profit of 50 cents a share, less expenses. Arbitrage may also involve the purchase of rights to subscribe to a security, or the purchase of a convertible security—and the sale at or about the same time of the security obtainable through exercise of the rights or of the security obtainable through conversion. (See: *Convertible, Rights*)

### Assets

Everything a corporation owns or due to it: Cash, investments, money due it, materials and inventories, which are called current assets; buildings and machinery, which are known as fixed assets; and patents and goodwill, called intangible assets. (See: *Liabilities*)

### At the Close Order

A market order which is to be executed at or as near to the close as practicable.

### At the Opening or At the Opening Only Order

A market or limited price order which is to be executed at the opening of the stock or not at all, and any such order or portion thereof not so executed is treated as cancelled.

### Averages

Various ways of measuring the trend of securities prices, the most popular of which is the Dow-Jones average of 30 industrial stocks listed on the New York Stock Exchange. The term average has led to considerable confusion. A simple average for, say, 50 leading stocks would be obtained by totaling the prices of all and dividing by 50. But suppose one of the stocks in the average is split. The price of each share of that stock is then automatically reduced because more shares are outstanding. The average would decline even if all other issues in the average were unchanged. That average thus becomes inaccurate as an indicator of the market's trend. Various formulas—some very elaborate—have been devised to compensate for stock splits and stock dividends and thus give continuity to the average. Averages and individual stock prices belong in separate compartments.

In the case of the Dow-Jones industrial average, the prices of the 30 stocks are totaled and then divided by a divisor which is intended to compensate for past stock splits and dividends and which is changed from time to time. As a result point changes in the average have only the vaguest relationship to dollar price changes in stocks included in the average. In November, 1968, the divisor was 2.011, so that a one-point change in the industrial average at that time was actually the equivalent of 6.7 cents. (See: *NYSE Common Stock Index, Point, Split*)

### Averaging

(See: *Dollar Cost Averaging*)

### Balance Sheet

A condensed statement showing the nature and amount of a company's assets, liabilities and capital on a given date. In dollar amounts the balance sheet shows what the company owned, what it owed, and the ownership interest in the company of its stockholders. (See: *Assets, Earnings Report*)

### Bear

Someone who believes the market will decline. (See: *Bull*)

### Bear Market

Declining market. (See: *Bull Market*)

### Bearer Bond

A bond which does not have the owner's name registered

on the books of the issuing company and which is payable to the holder. (See: *Coupon Bond, Registered Bond*)

### **Bid and Asked**

Often referred to as a quotation or quote. The bid is the highest price anyone has declared that he wants to pay for a security at a given time, the asked is the lowest price anyone will take at the same time. (See: *Quotation*)

### **Big Board**

A popular term for the New York Stock Exchange.

### **Blue Chip**

Common stock in a company known nationally for the quality and wide acceptance of its products or services, and for its ability to make money and pay dividends. Usually such stocks are relatively high priced and offer relatively low yields.

### **Blue Sky Laws**

A popular name for laws various states have enacted to protect the public against securities frauds. The term is believed to have originated when a judge ruled that a particular stock had about the same value as a patch of blue sky.

### **Board Room**

A room for customers in a broker's office where opening, high, low and last prices of leading stocks are posted on a board throughout the market day.

### **Bond**

Basically an IOU or promissory note of a corporation, usually issued in multiples of \$1,000, although \$100 and \$500 denominations are not uncommon. A bond is evidence of a debt on which the issuing company usually promises to pay the bondholders a specified amount of interest for a specified length of time, and to repay the loan on the expiration date. In every case a bond represents debt—its holder is a creditor of the corporation and not a part owner as is the shareholder. (See: *Collateral Trust Bond, Convertible, General Mortgage Bond, Income Bond*)

### **Book**

A notebook the specialist in a stock uses to keep a record of the buy and sell orders at specified prices, in sequence of receipt, which are left with him by other brokers. (See: *Specialist*)

### **Book Value**

An accounting term. Book value of a stock is determined from a company's records, by adding all assets (generally excluding such intangibles as good will), then deducting all debts and other liabilities, plus the liquidation value of any preferred issues. The sum arrived at is divided by the number of common shares outstanding and the result is book value per common share. Book value of the

assets of a company or a security may have little or no significant relationship to market value.

### **Broker**

An agent, often a member of a stock exchange firm or an exchange member himself, who handles the public's orders to buy and sell securities or commodities. For this service a commission is charged. (See: *Commission Broker, Dealer*)

### **Brokers' Loans**

Money borrowed by brokers from banks for a variety of uses. It may be used by specialists and odd-lot dealers to help finance inventories of stocks they deal in; by brokerage firms to finance the underwriting of new issues of corporate and municipal securities; to help finance a firm's own investments; and to help finance the purchase of securities for customers who prefer to use the broker's credit when they buy securities. (See: *Call Loan, Customers' Net Debit Balances, Margin*)

### **Bull**

Who believes the market will rise. (See: *Bear*)

### **Bull Market**

An advancing market. (See: *Bear Market*)

### **Call**

(See: *Puts and Calls*)

### **Call Loan**

A loan which may be terminated or "called" at any time by the lender or borrower. Used to finance purchases of securities. (See: *Brokers' Loans*)

### **Callable**

A bond issue, all or part of which may be redeemed by the issuing corporation under definite conditions before maturity. The term also applies to preferred shares which may be redeemed by the issuing corporation.

### **Capital Gain or Capital Loss**

Profit or loss from the sale of a capital asset. A capital gain, under current Federal income tax laws, may be either short-term (6 months or less) or long-term (more than 6 months). A short-term capital gain is taxed at the reporting individual's full income tax rate. A long-term capital gain is subject to a lower tax which may be computed in one of two ways. Under the first method, one-half the excess of net long-term capital gain over net short-term capital loss is deducted from income and is not taxed. Under the second method, known as the "alternative tax," and applicable generally to taxpayers with taxable income over the 50 percent rate bracket, up to \$50,000 (\$25,000 in the case of a married individual filing a separate return) of long-term

capital gain may be taxed at a maximum of 25 percent, depending upon the taxpayer's other capital gain and loss. The net long-term capital gain over the net short-term capital loss which does not qualify for the 25 percent rate will be taxed (for taxable years beginning in 1972) at the effective rate of one-half of whatever the applicable bracket rate may be. Under either method, the total tax must be computed with regard to the minimum tax on tax preferences since the excess of 50 percent of the net long-term capital gain over \$30,000 plus the taxpayer's regular tax constitutes an item of tax preference. Up to \$1,000 (\$500 in the case of a married individual filing a separate return) of net capital loss (that is, when you sell securities at a lower price than you paid for them) is deductible from the individual's taxable income during the year reported. If the net capital loss is a long-term capital loss, a deduction is allowed for only one-half of the net capital loss up to the maximum amount of \$1,000. If the net capital loss is more than \$1,000 in any one year (or \$2,000 if the net capital loss is a long-term capital loss), as much as \$1,000 annually may be deducted in future years until the amount deductible as a loss has been utilized. The amount of the net capital loss which may be deducted in future years is reduced by the amount of capital gain in such years. The capital gains provisions of the tax law are complicated. You should consult your tax adviser.

#### **Capital Stock**

All shares representing ownership of a business, including preferred and common. (See: *Common Stock, Preferred Stock*)

#### **Capitalization**

Total amount of the various securities issued by a corporation. Capitalization may include bonds, debentures, preferred and common stock and surplus. Bonds and debentures are usually carried on the books of the issuing company in terms of their par or face value. Preferred and common shares may be carried in terms of par or stated value. Stated value may be an arbitrary figure decided upon by the directors or may represent the amount received by the company from the sale of the securities at the time of issuance. (See: *Par*)

#### **Cash Flow**

Reported net income of a corporation plus amounts charged off for depreciation, depletion, amortization, extraordinary charges to reserves, which are bookkeeping deductions and not paid out in actual dollars and cents. (See: *Amortization, Depletion, Depreciation*)

#### **Cash Sale**

A transaction on the floor of the Stock Exchange which calls for delivery of the securities the same day. In "regular way" trades, the seller is to deliver on the fifth business day. (See: *Regular Way Delivery*)

#### **Certificate**

The actual piece of paper which is evidence of owner-

ship of stock in a corporation. Watermarked paper is finely engraved with delicate etchings to discourage forgery. Loss of a certificate may at the least cause a great deal of inconvenience—at the worst, financial loss.

#### **Central Certificate Service (CCS)**

A department of Stock Clearing Corporation which conducts a central securities certificate operation through which clearing firms effect security deliveries between each other via computerized bookkeeping entries thereby reducing the physical movement of stock certificates. (See: *Stock Clearing Corporation*)

#### **Closed-End Investment Trust**

(See: *Investment Trust*)

#### **Collateral**

Securities or other property pledged by a borrower to secure repayment of a loan.

#### **Collateral Trust Bond**

Bond secured by collateral deposited with a trustee. Collateral is often the stocks or bonds of companies controlled by the issuing company but may be other securities.

#### **Commission**

The broker's basic fee for purchasing or selling securities or property as an agent. The New York Stock Exchange currently fixes minimum commission rates applicable to orders to purchase or sell NYSE listed stocks involving \$500,000 or less. Commissions on portions of orders in excess of this amount are subject to negotiation. It is expected that the \$500,000 limitation for fixed commissions will be reduced to \$300,000 or lower in 1972.

#### **Commission Broker**

An agent who executes the public's orders for the purchase or sale of securities or commodities. (See: *Broker, Dealer*)

#### **Common Stock**

Securities which represent an ownership interest in a corporation. If the company has also issued preferred stock, both common and preferred have ownership rights, but the preferred normally has prior claim on dividends and, in the event of liquidation, assets. Claims of both common and preferred stockholders are junior to claims of bondholders or other creditors of the company. Common stockholders assume the greater risk, but generally exercise the greater control and may gain the greater reward in the form of dividends and capital appreciation. The terms common stock and capital stock are often used interchangeably when the company has preferred stock. (See: *Capital Stock, Preferred Stock*)

#### **Conglomerate**

A corporation seeking to diversify its operations by acquiring enterprises in widely varied industries.



### Consolidated Balance Sheet

A balance sheet showing the financial condition of a corporation and its subsidiaries. (See: *Balance Sheet*)

### Convertible

A bond, debenture or preferred share which may be exchanged by the owner for common stock or another security, usually of the same company, in accordance with the terms of the issue.

### Corner

Buying of a stock or commodity on a scale large enough to give the buyer, or buying group, control over the price. A person who must buy that stock or commodity, for example one who is short, is forced to do business at an arbitrarily high price with those who obtained the corner. (See: *Short Position, Short Sale*)

### Correspondent

A securities firm, bank or other financial organization which regularly performs services for another in a market to which the other does not have direct access. Securities firms may have correspondents in foreign countries or on exchanges of which they are not members. Correspondents are frequently linked by private wires. Member organizations of the N.Y.S.E. with offices in New York City also act as correspondents for out-of-town member organizations which do not maintain New York City offices.

### Coupon Bond

Bond with interest coupons attached. The coupons are clipped as they come due and are presented by the holder for payment of interest. (See: *Bearer Bond, Registered Bond*)

### Covering

Buying a security previously sold short. (See: *Short Sale, Short Covering*)

### Cumulative Preferred

A stock having a provision that if one or more dividends are omitted, the omitted dividends must be paid before dividends may be paid on the company's common stock.

### Cumulative Voting

A method of voting for corporate directors which enables the shareholder to multiply the number of his shares by the number of directorships being voted on and cast the total for one director or a selected group of directors. A 10-share holder normally casts 10 votes for each of 12 nominees to the board of directors. He thus has 120 votes. Under the cumulative voting principle he may cast that or he may cast 120 (10x12) votes for only one nominee, 60 for two, 40 for three, or any other distribution he

chooses. Cumulative voting is required under the corporate laws of some states, is permitted in most others.

### Curb Exchange

Former name of the American Stock Exchange, second largest exchange in the country. The term comes from the market's origin on a street in downtown New York.

### Current Assets

Those assets of a company which are reasonably expected to be realized in cash, or sold, or consumed during the normal operating cycle of the business. These include cash, U.S. Government bonds, receivables and money due usually within one year, and inventories.

### Current Liabilities

Money owed and payable by a company, usually within one year.

### Current Return

(See: *Yield*)

### Customers' Man

(See: *Registered Representative*)

### Customers' Net Debit Balances

Credit of New York Stock Exchange member firms made available to help finance customers' purchases of stocks, bonds and commodities.

### Day Order

An order to buy or sell which, if not executed expires at the end of the trading day on which it was entered.

### Dealer

An individual or firm in the securities business acting as a principal rather than as an agent. Typically, a dealer buys for his own account and sells to a customer from his own inventory. The dealer's profit or loss is the difference between the price he pays and the price he receives for the same security. The dealer's confirmation must disclose to his customer that he has acted as principal. The same individual or firm may function, at different times, either as broker or dealer. (See: *NASD, Specialist*)

### Debenture

A promissory note backed by the general credit of a company and usually not secured by a mortgage or lien on any specific property. (See: *Bond*)

### Depletion

Natural resources, such as metals, oils and gas, timber, which conceivably can be reduced to zero over the years,

present a special problem in capital management. Depreciation is an accounting practice consisting of charges against earnings based upon the amount of the asset taken out of the total reserves in the period for which accounting is made. A bookkeeping entry, it does not represent any cash outlay nor are any funds earmarked for the purpose.

### Depreciation

Normally, charges against earnings to write off the cost, less salvage value, of an asset over its estimated useful life. It is a bookkeeping entry and does not represent any cash outlay or are any funds earmarked for the purpose.

### Director

Person elected by shareholders to establish company policies. The directors appoint the president, vice presidents, and all other operating officers. Directors decide, among other matters, if and when dividends shall be paid. (See: *Management, Proxy*)

### Discretionary Account

An account in which the customer gives the broker or someone else discretion, which may be complete or within specific limits, as to the purchase and sales of securities or commodities including selection, timing, amount, and price to be paid or received.

### Discretionary Order

The customer empowers the broker to act on his behalf with respect to the choice of security to be bought or sold, a total amount of any securities to be bought or sold, and/or whether any such transaction shall be one of purchase or sale.

### Diversification

Spreading investments among different companies in different fields. Another type of diversification is also offered by the securities of many individual companies because of the wide range of their activities. (See: *Investment Trust*)

### Dividend

The payment designated by the Board of Directors to be distributed pro rata among the shares outstanding. On preferred shares, it is generally a fixed amount. On common shares, the dividend varies with the fortunes of the company and the amount of cash on hand, and may be omitted if business is poor or the directors determine to withhold earnings to invest in plant and equipment. Sometimes a company will pay a dividend out of past earnings even if it is not currently operating at a profit.

### Dollar Cost Averaging

A system of buying securities at regular intervals for a fixed dollar amount. Under this system the investor pays by the dollars' worth rather than by the number of shares.

If each investment is of the same number of dollars, payments buy more when the price is low and fewer when it rises. Thus temporary downswings in price benefit the investor if he continues periodic purchases in both good times and bad and the price at which the shares are sold is more than their average cost. (See: *Formula Investing*)

### Do Not Reduce "DNR" Order

A limited order to buy, a stop order to sell or a stop limit order to sell which is not to be reduced by the amount of an ordinary cash dividend on the ex-dividend date. A do not reduce order applies only to ordinary cash dividends; it is reduced for other distribution such as a stock dividend or rights.

### Double Taxation

Short for Double Taxation of Dividends. The federal government taxes corporate profits once as corporate income; any part of the remaining profits distributed as dividends to stockholders is taxed again as income to the recipient stockholder.

### Dow Theory

A theory of market analysis based upon the performance of the Dow-Jones industrial and rail stock price averages. The Theory says that the market is in a basic upward trend if one of these averages advances above a previous important high, accompanied or followed by a similar advance in the other. When the averages both dip below previous important lows, this is regarded as confirmation of a basic downward trend. The Theory does not attempt to predict how long either trend will continue, although it is widely misinterpreted as a method of forecasting future action. Whatever the merits of the Theory, it is sometimes a strong factor in the market because many people believe in the Theory—or believe that a great many others do. (See: *Technical Position*)

### Down Tick

(See: *Up Tick*)

### Earnings Report

A statement—also called an income statement—issued by a company showing its earnings or losses over a given period. The earnings report lists the income earned, expenses and the net result. (See: *Balance Sheet*)

### Equipment Trust Certificate

A type of security, generally issued by a railroad, to pay for new equipment. Title to the equipment, such as a locomotive, is held by a trustee until the notes are paid off. An equipment trust certificate is usually secured by a first claim on the equipment.

### Equity

The ownership interest of common and preferred stockholders in a company. Also refers to excess of value of securities over the debit balance in a margin account.

### Exchange Acquisition

A method of filling an order to buy a large block of stock on the floor of the Exchange. Under certain circumstances, a member-broker can facilitate the purchase of a block by soliciting orders to sell. All orders to sell the security are lumped together and crossed with the buy order in the regular auction market. The price to the buyer may be on a net basis or on a commission basis.

### Exchange Distribution

A method of disposing of large blocks of stock on the floor of the Exchange. Under certain circumstances, a member-broker can facilitate the sale of a block of stock by soliciting and getting other member-brokers to solicit orders to buy. Individual buy orders are lumped together and crossed with the sell order in the regular auction market. A special commission is usually paid to the seller; ordinarily the buyer pays no commission.

### Ex-Dividend

A synonym for "without dividend." The buyer of a stock selling ex-dividend does not receive the recently declared dividend. Open buy and sell stop orders, and sell stop limit orders in a stock on the ex-dividend date are ordinarily reduced by the value of that dividend. In the case of open stop limit orders to sell, both the stop price and the limit price are reduced. Every dividend is payable on a fixed date to all shareholders recorded on the books of the company as of a previous date of record. For example, a dividend may be declared as payable to holders of record on the books of the company on a given Friday. Since five business days are allowed for delivery of stock in a "regular way" transaction on the New York Stock Exchange, the Exchange would declare the stock "ex-dividend" as of the opening of the market on the preceding Monday. That means anyone who bought it on and after Monday would not be entitled to that dividend. (See: *Cash Sale, Delivery, Net Change, Transfer*)

### Ex-Rights

Without the rights. Corporations raising additional money may do so by offering their stockholders the right to subscribe to new or additional stock, usually at a discount from the prevailing market price. The buyer of a stock selling ex-rights is not entitled to the rights. (See: *Ex-Dividend, Rights*)

### Extra

The short form of "extra dividend." A dividend in the form of stock or cash in addition to the regular dividend the company has been paying.

### Face Value

The value of a bond that appears on the face of the bond, unless the value is otherwise specified by the issuing company. Face value is ordinarily the amount the issuing company promises to pay at maturity. Face value is not an indication of market value. Sometimes referred to as par value. (See: *Par*)

### Fill or Kill

A market or limited price order is to be executed in its entirety as soon as it is represented in the Trading Crowd. If not so executed, the order is treated as cancelled. For purposes of this definition a "stop" (See: *Stopped Stock*) is considered an execution.

### Fiscal Year

A corporation's accounting year. Due to the nature of their particular business, some companies do not use the calendar year for their bookkeeping. A typical example is the department store which finds December 31 nearly a date to close its books after the Christmas season. For that reason many stores wind up their accounting year January 31. Their fiscal year, therefore, runs from February 1 of one year through January 31 of the next. The fiscal year of other companies may run from July 1 through the following June 30. Most companies, though, operate on a calendar year basis.

### Fixed Charges

A company's fixed expenses, such as bond interest, which it has agreed to pay whether or not earned, and which are deducted from income before earnings on equity capital are computed.

### Flat

This term means that the price at which a bond is traded includes consideration for all unpaid accruals of interest. Bonds which are in default of interest or principal are traded flat. Income bonds, which pay interest only to the extent earned are usually traded flat. All other bonds are usually dealt in "and interest," which means that the buyer pays to the seller the market price plus interest accrued since the last payment date. When applied to a stock loan, flat means without premium or interest. (See: *Short Sale*)

### Floor

The huge trading area—about two-thirds the size of a football field—where stocks and bonds are bought and sold on the New York Stock Exchange.

### Floor Broker

Member of the Stock Exchange who executes orders on the floor of the Exchange to buy or sell any listed securities. (See: *Commission Broker, Two-Dollar Broker*)

### Floor Trader

(See: *Registered Trader*)

### Fluctuation

(See: *Point*)

### Formula Investing

An investment technique. One formula calls for the shifting of funds from common shares to preferred shares or bonds as the market, on average, rises above a certain predetermined point—and the return of funds to common share investments as the market average declines. (See: *Dollar Cost Averaging*)

### Free and Open Market

A market in which supply and demand are expressed in terms of price. Contrasts with a controlled market in which supply, demand and price may all be regulated.

### Funded Debt

Usually interest-bearing bonds or debentures of a company. Could include long-term bank loans. Does not include short-term loans, preferred or common stock.

### General Mortgage Bond

A bond which is secured by a blanket mortgage on the company's property, but which is often outranked by one or more other mortgages.

### Gilt-Edged

High-grade bond issued by a company which has demonstrated its ability to earn a comfortable profit over a period of years and pay its bondholders their interest without interruption.

### Give Up

A term with many different meanings. For one, a member of the Exchange on the floor may act for a second member by executing an order for him with a third member. The first member tells the third member that he is acting on behalf of the second member and "gives up" the second member's name rather than his own. For another, if you have an account with Doe & Company but you're in a town where Doe has no office, you go to another member firm, tell them you have an account with Doe & Company and would like to buy some stock. After verifying your account with Doe & Company, the firm may execute your order and tell the broker who sells the stock that the firm is acting on behalf of Doe & Company. They give up the name of Doe & Company to the selling broker. Or the firm may simply wire your order to Doe & Company who will execute it for you. The term "give up" has also been applied to a variety of other arrangements, most of which are no longer permitted.

### Good Delivery

Certain basic qualifications must be met before a security sold on the Exchange may be delivered. The security must be in proper form to comply with the contract of sale and to transfer title to the purchaser.

### Good 'Til Cancelled Order (GTC) or Open Order

An order to buy or sell which remains in effect until it is either executed or cancelled.

### Government Bonds

Obligations of the U. S. Government, regarded as the highest grade issues in existence.

### Growth Stock

Stock of a company with prospects for future growth—a company whose earnings are expected to increase at a relatively rapid rate.

### Guaranteed Bond

Bond which has interest or principal, or both, guaranteed by a company other than the issuer. Usually found in the railroad industry when large roads, leasing sections of trackage owned by small railroads, may guarantee the bonds of the smaller road.

### Guaranteed Stock

Usually preferred stock on which dividends are guaranteed by another company; under much the same circumstances as a bond is guaranteed.

### Hedge

(See: *Arbitrage, Puts & Calls, Selling Against the Box, Short Sale*)

### Holding Company

A corporation which owns the securities of another, in most cases with voting control.

### Hypothecation

The pledging of securities as collateral for a loan.

### Immediate or Cancel Order

A market or limited price order which is to be executed in whole or in part as soon as it is represented in the Trading Crowd, and the portion not so executed is to be treated as cancelled. For the purposes of this definition, a "stop" is considered an execution. (See: *Stopped Stock*)

### Inactive Post

A trading post on the floor of the New York Stock Exchange where inactive securities are traded in units

of 10 shares instead of the usual 100-share lots. Better known in the business as Post 30. (See: *Round Lot*)

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#### **Inactive Stock**

An issue traded on an exchange or in the over-the-counter market in which there is a relatively low volume of transactions. Volume may be no more than a few hundred shares a week or even less. On the New York Stock Exchange many inactive stocks are traded in 10-share units rather than the customary 100. (See: *Round Lot*)

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#### **In-and-Out**

Purchase and sale of the same security within a short period—a day, week, even a month. An in-and-out trader is generally more interested in day-to-day price fluctuations than dividends or long-term growth.

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#### **Income Bond**

Generally income bonds promise to repay principal but to pay interest only when earned. In some cases interest on an income bond may accumulate as a claim against the corporation when the bond becomes due. An income bond may also be issued in lieu of preferred stock.

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#### **Indenture**

A written agreement under which debentures are issued, setting forth maturity date, interest rate, and other terms.

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#### **Index**

A statistical yardstick expressed in terms of percentages of a base year or years. For instance, the Federal Reserve Board's index of industrial production is based on 1967 as 100. In January, 1972 the index stood at 107.9, which meant that industrial production that month was about 65 per cent higher than in the base period. An Index is not an average. (See: *Averages, NYSE Common Stock Index*)

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#### **Interest**

Payments a borrower pays a lender for the use of his money. A corporation pays interest on its bonds to its bondholders. (See: *Bond, Dividend*)

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#### **Investment**

The use of money for the purpose of making more money, to gain income or increase capital, or both. Safety of principal is an important consideration. (See: *Speculation*)

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#### **Investment Banker**

Also known as an underwriter. He is the middleman between the corporation issuing new securities and the public. The usual practice is for one or more investment

bankers to buy outright from a corporation a new issue of stocks or bonds. The group forms a syndicate to sell the securities to individuals and institutions. Investment bankers also distribute very large blocks of stocks or bonds—perhaps held by an estate. Thereafter the market in the security may be over-the-counter, on a regional stock exchange, the American Exchange or the New York Stock Exchange. (See: *Over-the-Counter, Primary Distribution, Syndicate*)

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#### **Investment Counsel**

One whose principal business consists of acting as investment adviser and a substantial part of his business consists of rendering investment supervisory services.

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#### **Investment Trust**

A company or trust which uses its capital to invest in other companies. There are two principal types: the closed-end and the open-end, or mutual fund. Shares in closed-end investment trusts, some of which are listed on the New York Stock Exchange, are readily transferable on the open market and are bought and sold like other securities. Capitalization of these companies remains the same unless action is taken to change, which is seldom. Open-end funds sell their own new shares to investors, stand ready to buy back their old shares, and are not listed. Open-end funds are so called because their capitalization is not fixed; they issue more shares as people want them.

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#### **Investor**

An individual whose principal concerns in the purchase of a security are regular dividend income, safety of the original investment, and, if possible, capital appreciation. (See: *Speculator*)

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#### **Issue**

Any of a company's securities, or the act of distributing such securities.

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#### **Legal List**

A list of investments selected by various states in which certain institutions and fiduciaries, such as insurance companies and banks, may invest. Legal lists are often restricted to high quality securities meeting certain specifications. (See: *Prudent Man Rule*)

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#### **Leverage**

The effect on the per-share earnings of the common stock of a company when large sums must be paid for bond interest or preferred stock dividends, or both, before the common stock is entitled to share in earnings. Leverage may be advantageous for the common when earnings are good but may work against the common stock when earnings decline. Example: Company A has 1,000,000 shares of common stock outstanding, no other securities. Earnings drop from \$1,000,000 to \$800,000 or

from \$1 to 80 cents a share, a decline of 20 per cent. Company B also has 1,000,000 shares of common but must pay \$500,000 annually in bond interest. If earnings amount to \$1,000,000, there is \$500,000 available for the common or 50 cents a share. But earnings drop to \$800,000 so there is only \$300,000 available for the common, or 30 cents a share—a drop of 40 per cent. Or suppose earnings of the company with only common stock increased from \$1,000,000 to \$1,500,000—earnings per share would go from \$1 to \$1.50, or an increase of 50 per cent. But if earnings of the company which had to pay \$500,000 in bond interest increased that much—earnings per common share would jump from 50 cents to \$1 a share, or 100 per cent. When a company has common stock only, no leverage exists because all earnings are available for the common, although relatively large fixed charges payable for lease of substantial plant assets may have an effect similar to that of a bond issue.

#### Liabilities

All the claims against a corporation. Liabilities include accounts and wages and salaries payable, dividends declared payable, accrued taxes payable, fixed or long-term liabilities such as mortgage bonds, debentures and bank loans. (See: *Assets, Balance Sheet*)

#### Lien

A claim against property which has been pledged or mortgaged to secure the performance of an obligation. A bond is usually secured by a lien against specified property of a company. (See: *Bond*)

#### Limit, Limited Order or Limited Price Order

An order to buy or sell a stated amount of a security at a specified price, or at a better price, if obtainable after the order is represented in the Trading Crowd.

#### Liquidation

The process of converting securities or other property into cash. The dissolution of a company, with cash remaining after sale of its assets and payment of all indebtedness being distributed to the shareholders.

#### Liquidity

The ability of the market in a particular security to absorb a reasonable amount of buying or selling at reasonable price changes. Liquidity is one of the most important characteristics of a good market.

#### Listed Stock

The stock of a company which is traded on a securities exchange, and for which a listing application and a registration statement, giving detailed information about the company and its operations, have been filed with the Securities & Exchange Commission, unless otherwise exempted, and the exchange itself. The various

stock exchanges have different standards for listing. Some of the guides used by the New York Stock Exchange for an original listing are national interest in the company, a minimum of 1-million shares publicly held among not less than 2,000 round-lot stockholders. The publicly held common shares should have a minimum aggregate market value of \$16 million. The company should have net income in the latest year of over \$2.5-million before federal income tax and \$2-million in each of the preceding two years.

#### Load

The portion of the offering price of shares of open-end investment companies which covers sales commissions and all other costs of distribution. The load is incurred only on purchase, there being, in most cases, no charge when the shares are sold (redeemed).

#### Locked In

An investor is said to be locked in when he has a profit in a security he owns but does not sell because his profit would immediately become subject to the capital gains tax. (See: *Capital Gain*)

#### Long

Signifies ownership of securities: "I am long 100 U. S. Steel" means the speaker owns 100 shares. (See: *Short Position, Short Sale*)

#### Management

The Board of Directors, elected by the stockholders, and the officers of the corporation, appointed by the Board of Directors.

#### Manipulation

An illegal operation. Buying or selling a security for the purpose of creating false or misleading appearance of active trading or for the purpose of raising or depressing the price to induce purchase or sale by others.

#### Margin

The amount paid by the customer when he uses his broker's credit to buy a security. Under Federal Reserve regulations, the initial margin required in the past 20 years has ranged from 40 per cent of the purchase price all the way to 100 per cent. (See: *Brokers' Loans, Equity, Margin Call*)

#### Margin Call

A demand upon a customer to put up money or securities with the broker. The call is made when a purchase is made; also if a customer's equity in a margin account falls below a minimum standard set by the Exchange or by the firm. (See: *Margin*)

### Market Order

An order to buy or sell a stated amount of a security at the most advantageous price obtainable after the order is represented in the Trading Crowd. (See: *Good 'til Cancelled Order, Limit Order, Stop Order*)

### Market Price

In the case of a security, market price is usually considered the last reported price at which the stock or bond sold.

### Matched and Lost

When two bids to buy the same stock are made on the trading floor simultaneously, and each bid is equal to or larger than the amount of stock offered, both bids are considered to be on an equal basis. So the two bidders flip a coin to decide who buys the stock. Also applies to offers to sell.

### Maturity

The date on which a loan or a bond or debenture is due and is to be paid off.

### Member Corporation

A securities brokerage firm, organized as a corporation, with at least one member of the New York Stock Exchange, Inc. who is a director and a holder of voting stock in the corporation. (See: *Member Firm*)

### Member Firm

A securities brokerage firm organized as a partnership and having at least one general partner who is a member of the N. Y. Stock Exchange. (See: *Member Corporation*)

### Member Organization

This term includes New York Stock Exchange Member Firm and Member Corporation. The term "participant" when used with reference to a Member Organization includes general and limited partners of a Member Firm and holders of voting and non-voting stock in a Member corporation. (See: *Member Corporation, Member Firm*)

### MIP

Monthly Investment Plan. A pay-as-you-go method of buying New York Stock Exchange listed shares on a regular payment plan for as little as \$40 a month, or \$40 every three months. Under MIP the investor buys stock by the dollars' worth—if the price advances, he gets fewer shares and if it declines, he gets more shares. He may discontinue purchases at any time without penalty. (See: *Dollar Cost Averaging, Open End Fund Dealer*)

### Mortgage Bond

A bond secured by a mortgage on a property. The value of the property may or may not equal the value of the so-called mortgage bonds issued against it. (See: *Bond, Debenture*)

### Municipal Bond

A bond issued by a state or a political subdivision, such as county, city, town or village. The term also designates bonds issued by state agencies and authorities. In general, interest paid on municipal bonds is exempt from federal income taxes and state and local income taxes within the state of issue.

### Mutual Fund

(See: *Investment Trust*)

### NASD

The National Association of Securities Dealers, Inc. An association of brokers and dealers in the over-the-counter securities business. The Association has the power to expel members who have been declared guilty of unethical practices. NASD is dedicated to—among other objectives—"adopt, administer and enforce rules of fair practice and rules to prevent fraudulent and manipulative acts and practices, and in general to promote just and equitable principles of trade for the protection of investors."

### Negotiable

Refers to a security, title to which is transferable by delivery. (See: *Delivery, Good Delivery*)

### Net Asset Value

A term usually used in connection with investment trusts, meaning net asset value per share. It is common practice for an investment trust to compute its assets daily, or even twice daily, by totaling the market value of all securities owned. All liabilities are deducted, and the balance divided by the number of shares outstanding. The resulting figure is the net asset value per share. (See: *Assets, Investment Trust*)

### Net Change

The change in the price of a security from the closing price on one day and the closing price on the following day on which the stock is traded. In the case of a stock which is entitled to a dividend one day, but is traded "ex-dividend" the next, the dividend is considered in computing the change. For example, if the closing market price of a stock on Monday—the last day it was entitled to receive a 50-cent dividend—was \$45 a share, and \$40 at the close of the next day, when it was "ex-dividend," the price would be considered unchanged. The same applies to a split-up of shares. A stock selling at \$100 the day before a 2-for-1 split and trading the next

day at \$50 would be considered unchanged. If it sold at \$51, it would be considered up \$1. The net change is ordinarily the last figure in the stock price list. The mark  $+1\frac{1}{2}$  means up \$1.125 a share from the last sale on the previous day the stock traded. (See: *Ex-Dividend, Point, Split*)

### New Issue

A stock or bond sold by a corporation for the first time. Proceeds may be issued to retire outstanding securities of the company, for new plant or equipment or for additional working capital.

### Noncumulative

A preferred stock on which unpaid dividends do not accrue. Omitted dividends are, as a rule, gone forever. (See: *Cumulative Preferred*)

### "Not Held" Order

A market or limited price order marked "not held," "disregard tape," "take time," or which bears any other qualifying notation. An order marked "or better" is a "not held" order.

### NYSE Common Stock Index

A composite index covering price movements of all common stocks listed on the "Big Board." It is based on the close of the market December 31, 1965 as 50.00 and is weighted according to the number of shares listed for each issue. The index is computed continuously by the Exchange's Market Data System and printed on the ticker tape each half hour. Point changes in the index are converted to dollars and cents so as to provide a meaningful measure of changes in the average price of listed stocks. The composite index is supplemented by separate indexes for four industry groups: industrials, transportation, utilities and finances. (See: *Averages*)

### Odd-Lot

An amount of stock less than the established 100-share unit or 10-share unit of trading: from 1 to 99 shares for the great majority of issues, 1 to 9 for so-called inactive stocks. (See: *Round Lot, Inactive Stock*)

### Odd-Lot Dealer

A member firm of the Exchange which buys and sells odd lots of stocks—1 to 9 shares in the case of stocks traded in 10-share units and 1 to 99 shares for 100-share units. The odd-lot dealer's customers are commission brokers acting on behalf of their customers. There are one or more odd-lot dealers who, under current practices, are ready to buy or sell, for their own accounts, odd lots in any stock at any time. Odd-lot prices are geared to the auction market. On an odd-lot market order, the odd-lot dealer's price is based on the first round-lot transaction which occurs on the floor following receipt at the trading

post of the odd-lot order. The usual differential between the odd-lot price and the "effective" round-lot price is  $12\frac{1}{2}$  cents a share for stock selling below \$55, 25 cents a share for stock at \$55 or more. For example: You decide to buy 20 shares of ABC common at the market. Your order is transmitted by your commission broker to the representative of an odd-lot dealer at the post where ABC is traded. A few minutes later there is a 100-share transaction in ABC at \$10 a share. The odd-lot price at which your order is immediately filled by the odd-lot dealer is \$10.125 a share. If you had sold 20 shares of ABC, you would have received \$9.875 a share. (See: *Commission Broker, Dealer, Inactive Stock, Round Lot, Transfer Tax*)

### Off-Board

This term may refer to transactions over-the-counter in unlisted securities, or to a transaction involving listed shares which was not executed on a national securities exchange. (See: *Over-the-Counter, Secondary Distribution*)

### Offer

The price at which a person is ready to sell. Opposed to bid, the price at which one is ready to buy. (See: *Bid and Asked*)

### Open-End Investment Trust

(See: *Investment Trust*)

### Open Order

(See: *Good 'til Cancelled Order*)

### Option

A right to buy or sell specific securities or properties at a specified price within a specified time. (See: *Puts and Calls*)

### Orders Good Until a Specified Time

A market or limited price order which is to be represented in the Trading Crowd until a specified time, after which such order or the portion thereof not executed is to be treated as cancelled.

### Overbought

An opinion as to price levels. May refer to a security which has had a sharp rise or to the market as a whole after a period of vigorous buying, which it may be argued, has left prices "too high." (See: *Technical Position*)

### Oversold

An opinion—the reverse of overbought. A single security or the market which, it is believed, has declined to an unreasonable level. (See: *Technical Position*)



### Over-The-Counter

A market for securities made up of securities dealers who may or may not be members of a securities exchange. Over-the-counter is mainly a market made over the telephone. Thousands of companies have insufficient shares outstanding, stockholders, or earnings to warrant application for listing on the N. Y. Stock Exchange, Inc. Securities of these companies are traded in the over-the-counter market between dealers who act either as principals or as brokers for customers. The over-the-counter market is the principal market for U. S. Government bonds and municipals and stocks of banks and insurance companies. (See: *NASD, Off-Board*)

### Paper Profit

An unrealized profit on a security still held. Paper profits become realized profits only when the security is sold.

### Par

In the case of a common share, par means a dollar amount assigned to the share by the company's charter. Par value may also be used to compute the dollar amount of the common shares on the balance sheet. Par value has little significance so far as market value of common stock is concerned. Many companies today issue no-par stock but give a stated per share value on the balance sheet. Par at one time was supposed to represent the value of the original investment behind each share in cash, goods or services. In the case of preferred shares and bonds, however, par is important. It often signifies the dollar value upon which dividends on preferred stocks, and interest on bonds, are figured. The issuer of a 3 per cent bond promises to pay that percentage of the bond's par value annually. (See: *Capitalization, Transfer Tax*)

### Participating Preferred

A preferred stock which is entitled to its stated dividend and, also, to additional dividends on a specified basis upon payment of dividends on the common stock.

### Passed Dividend

Omission of a regular or scheduled dividend.

### Penny Stocks

Low-priced issues often highly speculative, selling at less than \$1 a share. Frequently used as a term of disparagement, although a few penny stocks have developed into investment-caliber issues.

### Percentage Order

A market or limited price order to buy (or sell) a stated amount of a specified stock after a fixed number of shares of such stock have traded.

### Point

In the case of shares of stock, a point means \$1. If Gen-

eral Motors shares rise 3 points, each share has risen \$3. In the case of bonds a point means \$10, since a bond is quoted as a percentage of \$1,000. A bond which rises 3 points gains 3 per cent of \$1,000, or \$30 in value. An advance from 87 to 90 would mean an advance in dollar value from \$870 to \$900 for each \$1,000 bond. In the case of market averages, the word point means merely that and no more. If, for example, the Dow-Jones industrial average rises from 870.25 to 871.25, it has risen a point. A point in this average, however, is not equivalent to \$1. (See: *Averages*)

### Portfolio

Holdings of securities by an individual or institution. A portfolio may contain bonds, preferred stocks and common stocks of various types of enterprises.

### Preferred Stock

A class of stock with a claim on the company's earnings before payment may be made on the common stock and usually entitled to priority over common stock if company liquidates. Usually entitled to dividends at a specified rate—when declared by the Board of Directors and before payment of a dividend on the common stock—depending upon the terms of the issue. (See: *Cumulative Preferred, Participating Preferred*)

### Premium

The amount by which a preferred stock or bond may sell above its par value. In the case of a new issue of bonds or stocks, premium is the amount the market price rises over the original selling price. Also refers to a charge sometimes made when a stock is borrowed to make delivery on a short sale. May refer, also, to redemption price of a bond or preferred stock if it is higher than face value. (See: *Corner, Short Sale*)

### Price-Earnings Ratio

The current market price of a share of stock divided by earnings per share for a twelve-month period. For example, a stock selling for \$100 a share and earning \$5 a share is said to be selling at a price-earnings ratio of 20 to 1.

### Primary Distribution

Also called primary offering. The original sale of a company's securities. (See: *Investment Banker, Secondary Distribution*)

### Principal

A person for whom a broker executes an order, or a person buying or selling for his own account. The term "principal" may also refer to a person's capital or to the face amount of a bond.

### Proxy

Written authorization given by a shareholder to someone else to represent him and vote his shares at a shareholders' meeting.

### Proxy Statement

Information required by SEC to be given stockholders as a prerequisite to solicitation of proxies for a security subject to the requirements of Securities Exchange Act.

### Prudent Man Rule

An investment standard. In some states, the law requires that a fiduciary, such as a trustee, may invest the fund's money only in a list of securities designated by the state—the so-called legal list. In other states, the trustee may invest in a security if it is one which a prudent man of discretion and intelligence, who is seeking a reasonable income and preservation of capital, would buy.

### Puts and Calls

Options which give the right to buy or sell a certain amount of a certain stock at a specified price within a specified time. A put gives the holder the right to sell the stock; a call the right to buy the stock. Puts are purchased by those who think a stock may go down. A put obligates the seller of the contract to take delivery of the stock and pay the specified price to the owner of the option within the time limit of the contract. The price specified in a put or call is usually close to the market price of the stock at the time the contract is made. Calls are purchased by those who think a stock may rise. A call gives the holder the right to buy the stock from the seller of the contract at the specified price within a fixed period of time. Put and call contracts are written for 30, 60 or 90 days, or longer. Six months and ten days is the most common term. If the purchaser of a put or call does not wish to exercise the option, the price he paid for the option becomes a loss.

### Quotation

Often shortened to "quote." The highest bid to buy and the lowest offer to sell a security in a given market at a given time. If you ask your broker for a "quote" on a stock, he may come back with something like "45¼ to 45½." This means that \$45.25 is the highest price any buyer wanted to pay at the time the quote was given on the floor of the Exchange and that \$45.50 was the lowest price which any seller would take at the same time. (See: *Bid and Asked*)

### Rally

A brisk rise following a decline in the general price level of the market, or in an individual stock.

### Ratio of Collateral to Debt

The number of times total stock margin debt is covered

by total collateral value:

$$\frac{\text{Collateral Value}}{\text{Stock Margin Debt}} = \text{Ratio}$$

### Realizing (See: Profit Taking)

### Record Date

The date on which you must be registered as a shareholder on the stock book of a company in order to receive a declared dividend or, among other things, to vote on company affairs. (See: *Delivery, Ex-Dividend, Transfer*)

### Redemption Price

The price at which a bond may be redeemed before maturity, at the option of the issuing company. Redemption value also applies to the price the company must pay to call in certain types of preferred stock. (See: *Callable*)

### Refinancing

Same as refunding. New securities are sold by a company and the money is used to retire existing securities. It may be to save interest costs, extend the maturity of a loan, or both.

### Registered Bond

A bond which is registered on the books of the issuing company in the name of the owner. It can be transferred only when endorsed by the registered owner. (See: *Bearer Bond, Coupon Bond*)

### Registered Representative

Present name for the older term "customers' man." In a New York Stock Exchange Member Organization, a Registered Representative is a full time employee who has met the requirements of the Exchange as to background and knowledge of the securities business. Also known as an Account Executive or Customer's Broker.

### Registered Trader

A member of the Exchange who trades in stocks on the Floor for an account in which he has an interest.

### Registrar

Usually a trust company or bank charged with the responsibility of preventing the issuance of more stock than authorized by a company. (See: *Transfer*)

### Registration

Before a public offering may be made of new securities by a company, or of outstanding securities by controlling shareholders—through the mails or in interstate commerce—the securities must be registered under the Securities Act of 1933. Registration statement is filed with the SEC by the issuer. It must disclose pertinent information relating to the company's operations, securities,

management and purpose of the public offering. Securities of railroads under jurisdiction of the Interstate Commerce Commission, and certain other types of securities, are exempted. On security offerings involving less than \$300,000, less information is required.

Before a security may be admitted to dealings on a national securities exchange, it must be registered under the Securities Exchange Act of 1934. The application for registration must be filed with the exchange and the SEC by the company issuing the securities. It must disclose pertinent information relating to the company's operations, securities and management. Registration may become effective 30 days after receipt by the SEC of the certification by the exchange of approval of listing and registration, or sooner by special order of the Commission.

#### Regulation T

The federal regulation governing the amount of credit which may be advanced by brokers and dealers to customers for the purchase of securities. (See: *Margin*)

#### Regulation U

The federal regulation governing the amount of credit which may be advanced by a bank to its customer for the purchase of listed stocks. (See: *Margin*)

#### Return (See: *Yield*)

#### Rights

When a company wants to raise more funds by issuing additional securities, it may give its stockholders the opportunity, ahead of others, to buy the new securities in proportion to the number of shares each owns. The piece of paper evidencing this privilege is called a right. Because the additional stock is usually offered to stockholders below the current market price, rights ordinarily have a market value of their own and are actively traded. In most cases they must be exercised within a relatively short period. Failure to exercise or sell rights may result in actual loss to the holder. (See: *Warrant*)

#### Round Lot

A unit of trading or a multiple thereof. On the NYSE the unit of trading is generally 100 shares in stocks and \$1,000 par value in the case of bonds. In some inactive stocks, the unit of trading is 10 shares.

#### Scale Order

An order to buy (or sell) a security which specifies the total amount to be bought (or sold) and the amount to be bought (or sold) at specified price variations.

#### Seat

A traditional figure-of-speech for a membership on an exchange. Price and admission requirements vary.

#### SEC

The Securities and Exchange Commission, established

by Congress to help protect investors. The SEC administers the Securities Act of 1933, the Securities Exchange Act of 1934, the Trust Indenture Act, the Investment Company Act, the Investment Advisers Act, and the Public Utility Holding Company Act.

#### Secondary Distribution

Also known as a secondary offering. The redistribution of a block of stock some time after it has been sold by the issuing company. The sale is handled off the NYSE by a securities firm or group of firms and the shares are usually offered at a fixed price which is related to the current market price of the stock. Usually the block is a large one, such as might be involved in the settlement of an estate. The security may be listed or unlisted. (See: *Exchange Distribution, Investment Banker, Primary Distribution, Special Offering, Syndicate*)

#### Seller's Option

A special transaction on NYSE which gives the seller the right to deliver the stock or bond at any time within a specified period, ranging from not less than six business days to not more than 60 days. (See: *Delivery*)

#### Serial Bond

An issue which matures in relatively small amounts at periodic stated intervals.

#### Service Charge

In April, 1970 an interim service charge was imposed on orders of 1,000 shares or less, pending establishment of a new commission rate schedule. The charge—not less than \$15.00 or 50% of the minimum commission applicable to the order, whichever is less—was initially to remain in effect for 90 days.

In July, 1970, the service charge was extended for an indefinite period. It has been generally assumed that it will terminate with the adoption of a new commission schedule.

#### Short Covering

Buying stock to return stock previously borrowed to make delivery on a short sale.

#### Short Position

Stocks sold short and not covered as of a particular date. On the NYSE, a tabulation is issued once a month listing all issues on the Exchange in which there was a short position of 5,000 or more shares and issues in which the short position had changed by 2,000 or more shares in the preceding month. Short position also means the total amount of stock an individual has sold short and has not covered, as of a particular date. (See: *Margin, Up Tick, Short Sale*)

### Short Sale

A person who believes a stock will decline and sells it though he does not own any has made a short sale. For instance: You instruct your broker to sell short 100 shares of ABC. Your broker borrows the stock so he can deliver the 100 shares to the buyer. The money value of the shares borrowed is deposited by your broker with the lender. Sooner or later you must cover your short sale by buying the same amount of stock you borrowed for return to the lender. If you are able to buy ABC at a lower price than you sold it for, your profit is the difference between the two prices—not counting commissions and taxes. But if you have to pay more for the stock than the price you received, that is the amount of your loss. Stock exchange and federal regulations govern and limit the conditions under which a short sale may be made on a national securities exchange. Sometimes a person will sell short a stock he already owns in order to protect a paper profit. This is known as selling against the box. (See: *Margin, Premium, Up Tick*)

### Sinking Fund

Money regularly set aside by a company to redeem its bonds, debentures or preferred stock from time to time as specified in the indenture or charter.

### Special Bid

A method of filling an order to buy a large block of stock on the floor of the New York Stock Exchange. In a special bid, the bidder for the block of stock—a pension fund, for instance, will pay a special commission to the broker who represents him in making the purchase. The seller does not pay a commission. The special bid is made on the floor of the Exchange at a fixed price which may not be below the last sale of the security or the current bid in the regular market, whichever is higher. Member firms may sell this stock for customers directly to the buyer's broker during trading hours.

### Special Offering

Occasionally a large block of stock becomes available for sale which, due to its size and the market in that particular issue, calls for special handling. A notice is printed on the ticker tape announcing that the stock will be offered for sale on the NYSE floor at a fixed price. Member firms may buy this stock for customers directly from the seller's broker during trading hours. The price is usually based on the last transaction in the regular auction market. If there are more buyers than stock, allotments are made. Only the seller pays a commission on a special offering. (See: *Secondary Distribution*)

### Specialist

A member of the New York Stock Exchange who has two

functions: First, to maintain an orderly market, insofar as reasonably practicable, in the stocks in which he is registered as a specialist. In order to maintain an orderly market, the Exchange expects the specialist to buy or sell for his own account, to a reasonable degree, when there is a temporary disparity between supply and demand. Second, the specialist acts as a broker's broker. When a commission broker on the Exchange floor receives a limit order, say, to buy at \$50 a stock then selling at \$60—he cannot wait at the post where the stock is traded until the price reaches the specified level. So he leaves the order with the specialist, who will try to execute it in the market if and when the stock declines to the specified price. At all times the specialist must put his customers' interests above his own. There are about 350 specialists on the NYSE. (See: *Book, Limited Order*)

### Specialist Block Purchase

Purchase by a specialist for his own account of a large block of stock outside the regular Exchange market. Such purchases may be made only when the sale of the block could not be made in the regular market within a reasonable time and at reasonable prices, and when the purchase by the specialist would aid him in maintaining a fair and orderly market. The specialist need not fill the orders on his book down to the purchase price.

### Specialist Block Sale

Opposite of the specialist block purchase. Under exceptional circumstances, the specialist may sell a block of stock outside the regular market on the Exchange for his own account at a price above the prevailing market. The price is negotiated between the specialist and the broker for the buyer. The specialist need not fill the orders on his book down to the purchase price.

### Speculation

The employment of funds by a speculator. Safety of principal is a secondary factor. (See: *Investment*)

### Speculator

One who is willing to assume a relatively large risk in the hope of gain. His principal concern is to increase his capital rather than his dividend income. The speculator may buy and sell the same day or speculate in an enterprise which he does not expect to be profitable for years. (See: *Investor*)

### Split

The division of the outstanding shares of a corporation into a larger number of shares. A 3-for-1 split by a company with 1 million shares outstanding results in 3 million shares outstanding. Each holder of 100 shares before the 3-for-1 split would have 300 shares, although his proportionate equity in the company would remain the same; 100 parts of 1 million are the equivalent of 300 parts of 3 million. Ordinarily splits must be voted by directors and approved by shareholders. (See: *Stock Dividends*)