2. The Problems of Portfolio Management

In addition to valuation, restricted securities present special problems of portfolio management.

The concept of the Securities Act exemption of a private placement of securities is premised on the belief that in such a situation the investor has such information concerning the issuer that he is able to fend for himself without need for the disclosures that would be provided by an effective registration statement. Correlatively, where the investor is a registered investment company, it would seem to be the fiduciary duty of the persons responsible for the investment decisions of the investment company to obtain, prior to purchase, the necessary information to make an independent analysis of the investment merits of the particular restricted securities. 2/ Also, in order to enable the continuing valuation of such securities, the investment company should require the seller to undertake to provide, to the extent known to the seller, information on a continuing basis as to any subsequent private sales of the issuer's securities. The investment company should also assure itself that it is in the position to obtain the appropriate financial information at appropriate times. It is assumed that any public disclosures, such as that made in periodic reports filed pursuant to the Securities Exchange Act, are carefully considered by the investment company portfolio manager.

There is also the paradox of too much success to consider. For example, if restricted securities rapidly appreciate in value, perhaps because of an improvement in the business of the issuer, an investment company may find instead of having, for example, 5 per cent of its assets invested in a particular company, it has instead, 25 per cent of its assets in that company. The investment company to which this happens suffers a loss in diversification and may find that it has become overly sensitive to any adverse developments in the affairs of that particular portfolio company.

The foregoing factors in portfolio management relate to both open-end and closed-end management companies. There are additional special factors that relate only to open-end companies.

Section 2(a)(31), when read together with Section 5(a), of the Investment Company Act requires that the holders of redeemable shares issued by an open-end investment company be entitled to receive approximately their proportionate share of the issuer's current net assets, or the cash equivalent thereof, upon presentation of the security to the issuer or to a person designated by the issuer. Section 22(e) of the Act provides that, absent specified unusual conditions, payment of the redemption price must be made within seven days after the tender of a redeemable security to an investment company or its agent designated for that purpose.

2/ See The Value Line Fund v. Marcus ('64-'66 Transfer Binder) CCH Fed'l. Sec. Law Rep. ¶ 91,523 at p. 94,970 (S.D. N. Y. 1965).

It is desirable that an open-end company retain maximum flexibility in the choice of portfolio securities which, on the basis of their relative investment merits, could best be sold where necessary to meet redemptions. To the extent that the portfolio consists of restricted securities, this flexibility is reduced.

Restricted securities may not be publicly sold--nor can they be distributed to redeeming shareholders as an in-kind redemption. While they may be sold privately, there may not be sufficient time to obtain the best price since the date of payment or satisfaction may not be postponed more than seven days after the tender of the company's redeemable securities for redemption. A private sale within that period may result in the investment company receiving less than its carrying value of the restricted securities. This would result in a preference in favor of the redeeming shareholders and a diminution of the net asset value per share of shareholders who have not redeemed. Therefore, instead of arranging a private sale of restricted securities, an open-end company that is faced with redemptions may decide to sell unrestricted securities which it would otherwise have retained on the basis of comparative investment merit.

Significant holdings of restricted securities not only magnify the valuation difficulties but may also present serious liquidity questions. Because open-end companies hold themselves out at all times as being prepared to meet redemptions within seven days, it is essential that such companies maintain a portfolio of investments that enable them to fulfill that obligation. This requires a high degree of liquidity in the assets of open-end companies because the extent of redemption demands or other exigencies are not always predictable. It has been with this in mind that the staff of the Commission has for several years taken the position that an open-end company should not acquire restricted securities when the securities to be acquired, together with other such assets already in the portfolio, would exceed 15 per cent of the company's net assets at the time of acquisition. The Commission, however, is of the view that a prudent limit on any open-end company's acquisition of restricted securities, or other assets not having readily available market quotations, would be 10 per cent. 3/ When as a result of either the increase in the value of some or all of the restricted securities held, or the diminution in the value of unrestricted securities in the portfolios, the restricted securities come to represent a larger percentage of the value of the company's net assets,

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3/ The Commission is aware that certain open-end companies my have acquired restricted securities in excess of 10 per cent of net assets. It is assumed that such companies will not undertake commitments, beyond any obligation existing on this date, to acquire restricted securities until, in the normal course of business, such holdings are not in excess of 10 per cent of current net asset value.

the same valuation and liquidity questions occur. Accordingly, if the fair value of restricted holdings increases beyond 10 per cent, it would be desirable for the open-end company to consider appropriate steps to protect maximum flexibility. The Commission will re-examine appropriate limitations in this area in light of all the policy objectives of the Investment Company Act.

3. The Problem of Disclosure

Section 8(b)(1)(D) of the Investment Company Act requires that an investment company include, in its registration statement filed with the Commission under the Act, information as to its policy with respect to "engaging in the business of underwriting securities issued by other persons." Item 4(c) of Form N-8B-1 requires that a registrant under the Act describe its policy or proposed policy with respect to "the underwriting of securities of other issuers." In response to this item, registrant's policy with respect to the acquisition of restricted securities should be disclosed. 4/ In view of the fact that policies listed under Item 4 are fundamental policies which cannot be changed without prior shareholder approval, the importance of adopting a clear policy with regard to such investments is apparent.

The prospectus of a registered investment company should also fully disclose the company's policy with respect to restricted securities. 5/ It is also clear that an investment company which has a policy of acquiring restricted securities is responsible for full and adequate disclosure with respect to all matters relating to the valuation of such securities. Specifically, there should be included, in a note to the financial statements, (1) identification of any restricted securities and the date of acquisition, (2) disclosure of the methods used in valuing such securities both at the date of acquisition and the date of the financial statements, (3) disclosure of the cost of such securities and the market quotation for unrestricted securities of the same class both on the day the purchase price was agreed to (the so-called "handshake date"), and on the day the investment company first obtained an enforceable right to acquire such securities, and (4) a statement as to whether the issuer or the registrant will bear costs, including those involved in registration under the Securities Act, in connection with the disposition of such securities.

4/ See Proposed Guidelines For the Preparation of Form N-8B-1, Investment Company Act Release No. 5633, p. 7 (March 11, 1969).

5/ See Proposed Guidelines For The Preparation Of Forms S-4 and S-5, Investment Company Act Release No. 5634, pp. 11, 13 (March 11, 1969).

Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder makes it unlawful, among other things, for any person, in connection with the purchase or sale of securities, to employ any device, scheme, or artifice to defraud or to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made not misleading, or engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any persons.

The offering price of securities issued by a management investment company is premised upon the net asset value of such shares as determined pursuant to Section 2(a)(39) of the Act and Rule 2a-4 thereunder and is so represented in its prospectus. The improper valuation of restricted securities held by such a company would distort the net asset value of the shares being offered or, in the case of an open-end company, redeemed, and would therefore constitute a fraud and deceit within the meaning of Section 10(b) and Rule 10b-5.

An open-end company, of course, represents to investors, in its prospectus, that it will, as required by Section 22(e) of the Act, redeem its securities at approximate net asset value within seven days after tender. To the extent a material percentage of the assets of an open-end company consist of restricted securities which cannot publicly be sold without registration under the Securities Act, the ability of the company to comply with the provisions of the Investment Company Act relating to redemption, and to fulfill the implicit representations made in its prospectus with respect thereto, may be adversely affected. 6/ In any such situation, the investment company concerned and the persons responsible for the sale of its securities should give careful consideration to the possible application of the provisions of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

6/ See Proposed Guidelines For The Preparation Of Form N-8B-1, Investment Company Act Release No. 5633, p. 7 (March 11, 1969).

FOR RELEASE Thursday, April 6, 1972

SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549

INVESTMENT COMPANY ACT OF 1940
Release No. 7113
INVESTMENT ADVISERS ACT OF 1940
Release No. 315

FACTORS TO BE CONSIDERED IN CONNECTION WITH INVESTMENT COMPANY ADVISORY CONTRACTS CONTAINING INCENTIVE FEE ARRANGEMENTS

The Securities and Exchange Commission today called the attention of all registered investment companies, their officers and directors and their investment advisers to certain factors which must be considered in connection with investment company incentive fee arrangements in view of the provisions of the Investment Company Amendments Act of 1970, Public Law 91-547 ("1970 Act").

Section 205 of the Advisers Act was amended by the 1970 Act in order to provide protection against performance fee arrangements which are unfair to investment companies. It prohibits all performance fees unless compensation under them increases and decreases proportionately with the investment performance of the company over a specified period in relation to the investment record of an appropriate index of securities prices or such other measure of investment performance as the Commission by rule, regulation or order may specify. The point from which increases and decreases in incentive compensation are measured must be the fee which is paid or earned when the investment performance of the company is equivalent to that of the index or other measure of performance.

Section 15 of the Investment Company Act ("the Act") sets forth the requirements for approval of advisory contracts of registered investment companies. Section 15(c), as amended, requires investment company directors to request and evaluate, and the investment adviser to furnish, such information as may reasonably be necessary to evaluate the terms of the advisory contract. 1/

1/ The Commission has previously issued a release setting forth certain of its views with respect to the approval of advisory contracts under the 1970 Act (IC Release No. 6336, February 2, 1971) and another release setting forth certain views of its Division of Corporate Regulation respecting the fiduciary duties of directors under Section 36(a) of the 1970 Act (IC Release No. 6480, May 10, 1971).

Prior to the amendment of Section 205 many investment company performance fee arrangements were unfair to investment companies. Many incentive fees did not decrease for poor performance, or if they did, decreases were disproportionate to the increases. In addition, in some cases, the index against which investment company performance was measured was inappropriate and prejudicial to investment companies.

The Commission has surveyed the performance fee arrangements of registered investment companies in effect as of January 3, 1972, in order to evaluate such arrangements in view of the requirements of amended Section 205 of the Advisers Act and the fiduciary standards of the Investment Company Act. Of 999 management open-end and closed-end investment companies, 103 had performance fee arrangements on that date. The survey indicated that although many of the unfair features of previous performance fee arrangements have been eliminated, some performance fee arrangements still contain features which create bias against investment companies and do not conform to the provisions of Section 205 of the Advisers Act or the fiduciary standards of the Investment Company Act. These features include selection of an inappropriate index, computation of investment company average net assets and performance over different intervals and failure to reflect the reinvestment of dividends paid from investment income in computing investment company investment performance and of all cash distributions in computing the investment record of the index. 2/ As is explained below, these practices result in measuring investment company performance on a basis that is unfair to the investment company, and which does not relate to the investment record of the index.

The Commission is also concerned with incentive fee arrangements which permit significant fee adjustments based on random or insignificant differences rather than meaningful differences in the performance of the investment company and the index. This may occur, for example, where the maximum incentive fee or penalty is paid for the slightest performance difference or where significant performance fee adjustments are based on random or insignificant performance differences.

2/ Reinvestment means treating amounts distributed by an investment company as invested in shares of the investment company at the record dates of the distributions and treating amounts distributed by the companies which comprise the index as invested in the securities which comprise the index as soon as possible after their ex-dividend or record dates, rather than at the end of the measurement period. Such treatment gives proper effect to dividends and distributions during the measurement period.

The Fairness of the Fulcrum Fee

Any consideration of the fairness of a performance fee arrangement must start with the midpoint or "fulcrum fee" (the fee paid when the investment company's performance equals that of the index). The maximum and minimum incentive fee rates and all performance increments are measured from the fulcrum fee. Thus, the selection of a fair fulcrum fee is a critical prerequisite to a fair performance fee. This means that the same factors should be considered in arriving at a fair fulcrum fee as are taken into account in establishing the proper fee under advisory contracts which do not involve incentive compensation. 3/

Selection of an Appropriate Index

As indicated above, Section 205 requires that the investment performance of the investment company be measured against the investment record of an appropriate index of securities prices. In determining whether an index is appropriate for a particular investment company, directors should consider factors such as the volatility, diversification of holdings, types of securities owned and objectives of the investment company. For example, for investment companies that invest in a broad range of common stocks, a broadly based market value weighted index of common stocks ordinarily would be an appropriate index, 4/ but an index based upon a relatively few large "blue chip" stocks would not. For investment companies that invest exclusively in a particular type of security or industry, either a specialized index that adequately represents the performance of that type of security or a broadly based market value weighted index ordinarily would be considered appropriate. 5/ Of course, if an investment company invests in a particular type of security an index which measures the performance of another particular type of security would

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3/ The Report of the Committee on Interstate and Foreign Commerce of the House of Representatives on the 1970 Act states that "(T)he fiduciary duty with respect to management compensation contained in...new section 36(b) of the Act would apply to compensation received pursuant to a performance-related contract permitted by section 205 to the same extent as it does to other types of investment advisory contracts." H. Rep. 91-1382, p. 41 (91st Cong., 2nd Sess., August 7, 1970). See also S. Rep. 91-184, p. 45 (91st Cong., 1st Sess., May 21, 1969).

4/ See the Institutional Investor Study, Vol. 2, H. Doc. 92-64, 92nd Cong., 1st Sess. Pt. 2, March 10, 1971, p. 408.

5/ An index may be computed on a weighted or unweighted basis, but in no event should the index be weighted by fortuitous considerations such as the price per share. Certain averages which are weighted by price give greater weight to the stocks in the index having higher market prices. An effect of this is to give proportionately less weight to stocks after price appreciation leads to a stock split. These completely fortuitous considerations penalize growth and make such averages inappropriate, regardless of the type of securities held by the investment company, as a basis for comparison with investment company investment performance.

not be appropriate. 6/

Variations in Periods Used For Computing Average Asset Values and Performance

In computing compensation for incentive fee arrangements, variations in the time interval over which average asset value and investment performance are computed can make a significant difference. The larger the asset base, the greater the amount of compensation which will be added or deducted for performance and the more volatile performance compensation will be. For example, if average assets are based upon average daily assets over the last 3 months of a 36 month performance period (or the last month of an annual performance period) it is possible that, as a result of accumulated sales, there would be greater average assets than there would be if assets were averaged over the entire period. Thus, the amount of assets to which the performance fee rate would be applied would be greater. In effect, the use of the shorter period will have raised the "performance ante." Ironically, it will also cause the amount of compensation, which supposedly is paid for "performance", to be related significantly to the amount of sales. 7/

Section 205 of the Advisers Act requires that compensation be based on the asset value of the company averaged over a specified period and increasing and decreasing proportionately with the investment performance of the company over a specified period in relation to the investment record of an appropriate index of securities prices. The use of different periods for averaging assets and computing investment performance would be unfair to the investment company and would violate Section 205. 8/

6/ Technical methods for specifying incentive fees based upon risk or volatility adjusted returns are now being explored by the staff and a number of industry and academic groups as well as commercial enterprises. However, the Commission has not, at this time, arrived at any conclusions with respect to these methods.

7/ On the other hand, if performance has been poor, the impact of declining asset values and decreased sales could be greatest at the end of the period. This would tend to lower the asset base for investment companies which have had poor performance.

8/ Similarly, if the period over which net asset values are averaged for computing the fulcrum fee differs from the period over which net asset values are averaged for computing the performance related portion of the fee, it could result in incentive payments having a disproportionate relationship to the fulcrum fee. The Section 205 requirement that "compensation" be based upon the asset value of the company "averaged over a specified period" means that the same period must be used for computing average assets for the fulcrum fee and the performance fee segments of the adviser's compensation.

Length of Period over which Performance is Computed

Although Section 205 of the Advisers Act does not require that performance be measured over a period of any particular length, there is a fiduciary obligation to use an interval sufficiently long to provide a reasonable basis for indicating the adviser's performance. All 103 investment companies surveyed measured their performance over a period of at least one year. Use of at least a one year interval minimizes the possibility that payments will be based upon random or short term fluctuations.

Computation of Performance Over a "Rolling Period"

Over 43 percent of the companies surveyed (45 companies) measured their performance on the basis of a rolling period, a moving average of the number of subperiods (i.e., months or quarters) included in the full period over which performance is measured. Section 205 of the Advisers Act does not specify that either a rolling period or a flat period be used. However, there are a number of advantages, both from the shareholders' and the adviser's point of view, in using a rolling average.

For example, since Section 205 requires that performance be measured over a "specified period", in the absence of a specified fixed or rolling period, compensation cannot be precisely computed or paid until that period has expired and the investment company's performance for the entire period is known. In other words, interim payments based upon interim performance are not permissible under Section 205. 9/ Use of a rolling period for computation of a performance fee avoids the problem of interim payments. It permits payments based upon performance to be made more frequently than annually, since each payment would be based upon performance over the preceding twelve months or longer period adopted.

Rule 2a-4 under the Investment Company Act requires that investment company shares be sold at their approximate net asset value. To do this, amounts reflecting the performance fee must be accrued on a daily basis. Use of a rolling period avoids accruing a performance fee on the basis of periods of substantially less than one year and smoothes out accruals resulting from short term fluctuations in performance. For contracts computed on the basis of a period of one year or more, but without the use of a rolling period, accruals for the performance fee near the beginning of the period would be based upon periods of substantially less than a year. Under a rolling period contract, accruals for the performance fee can be computed on the basis of a period of at least 11 months or three quarters of a year (the time elapsed, depending upon the sub-periods adopted, when the daily accrual in the current computation period commences) and thus the effects on accruals of short-term performance would be minimized and accruals would better reflect overall performance and the fee ultimately payable.

9/ Of course, if a fee schedule provides for the payment of a minimum fee regardless of performance, interim payments based solely on the minimum fee would be permissible.

Performance Fee Transitional Periods

A difficulty arises in connection with the "start-up" or transitional period for performance fees when a performance fee is based upon a period for which investment results are already known or for which the adviser has already received compensation under the previous contract. To the extent that performance during the earlier period adds to the adviser's compensation, in essence he will be compensated twice for the same period and the same performance. Moreover, the investment company's positive performance during the period prior to adoption of the performance fee gives the adviser a "running start" on the index. If such an arrangement were permitted, the investment company would not have to outperform the index during the balance of the period covered by the performance fee in order that its adviser collect a performance fee. If the investment company merely maintained its relative performance for the balance of the specified period, the adviser nevertheless would collect a fee for "outperforming" the index. For example, if a 36 month rolling performance fee were adopted which included 18 months for which performance results were already known, and during which the performance of the investment company was greater than that of the index, the investment performance of the investment company could be the same as that of the index over the next 18 months but the adviser, nevertheless, would receive a performance fee for "outperforming" the index. Elementary fiduciary standards require that performance compensation be based only upon results obtained after such contracts take effect. In other words, a performance fee contract may be instituted on a prospective basis only. 10/

A transitional problem may also result if a contract containing an investment company performance fee arrangement is cancelled before its expiration date and the same adviser is rehired under a straight percentage of assets contract. Assume, for example, that an investment company's performance over the first half of the period specified in its contract is significantly worse than the investment record of the index and that it appears unlikely that the adviser will earn any incentive fee, or even the fulcrum fee, over the full term of the contract. It may be to the adviser's advantage to attempt to renegotiate his contract and to substitute a contract without a performance fee, but at a fee higher than that which it could earn under the original contract. Such substitution would be unfair to the investment company. If an adviser could cancel a performance contract during a period for which a performance fee is to be computed and recontract on a percentage of assets basis, such contracts would once again amount to the kind of "one way street" that existed prior to the enactment of Section 205. To prevent this, such a new contract should provide that the fee payable until the end of the performance fee computation period of the original contract shall be the lesser of the amount which would have been paid under the original contract or the amount payable under the new contract.

10/ Of course, under any performance fee arrangement incentive compensation is based upon results achieved over an earlier period. However, those results have not been determined before the contract is adopted.

Similarly, cancellation of a "rolling" performance fee contract during a period of substandard performance could be unfair to the investment company if a percentage of assets or different performance fee contract with the same adviser were substituted. The appropriate method of "winding down" a rolling performance fee contract would be to give the investment company substantial advance notice, (i.e., not less than half of the fee computation period specified in the contract) of the adviser's intention to cancel the contract and to provide that the fee payable during such "winding down" period shall be the lesser of the amount which would have been due under the original contract or the fee payable under the new contract.

Computation of the "Investment Performance" of the Investment Company and the "Investment Record" of the Index with Respect to Payment of Dividends from Investment Income and Distributions of Realized Capital Gains

As indicated in the Institutional Investor Study, the best measure of the total benefits received by investment company shareholders during a specified period is one that reflects changes in net asset value of the company's shares with adjustments to compensate for the payment of any realized capital gains distributions and dividends from investment income during the evaluation period. This measure gives effect to all increments in value received by stockholders and has been widely used without any serious challenge to its propriety. 11/

Section 205 of the Advisers Act requires that compensation increase and decrease proportionately based upon investment performance of the investment company in relation to the investment record of the index, as distinguished from the index price. In 93 percent of investment companies with performance fee arrangements capital gains distributions were treated as reinvested in computing investment performance. Such reinvestment is necessary in order that investment company performance be computed on the same basis as the index, since capital gains are neither realized nor distributed with respect to the companies comprising the index. Unless investment company capital gains distributions are treated as reinvested in computing investment company investment performance, such performance would not relate to the investment record of the index.

Similarly, dividends paid from investment income on investment company shares and cash distributions on the securities which comprise the index are significant factors which cannot be overlooked in computing the "investment record" of the index and in relating investment

11/ Institutional Investor Study Report, Vol. 2, H. Doc. 92-64, 92nd Cong., 1st Sess. Part 2, March 10, 1971, p. 409.

company investment performance to that investment record. On the average, the dividends paid from investment income by investment companies with performance fee arrangements have been less than the cash dividends paid on the securities of the companies which comprise the indices used in performance comparisons. Thus, in many cases, ignoring dividends and any other cash distributions in relating investment company investment performance to the investment record of the index can give investment advisers a substantial advantage.

To correct this, the Commission, pursuant to its authority under Sections 205 and 211 of the Advisers Act, has proposed rules defining the terms "investment performance" and "investment record" as they are used in Section 205 of that Act 12/to make clear that such provision requires inclusion of dividends paid from investment income and realized capital gains distributions of the investment company and of cash distributions on the securities of companies which comprise the index.

Avoid Basing Significant Fee Adjustments upon Random or Insignificant Differences

In structuring incentive fee arrangements it is important to build in a degree of confidence that any significant incentive payments (or penalties) are attributable to the adviser's skill, or lack of skill, rather than to random fluctuations. Most investment company incentive fee contracts have "step rates". 13/ Generally, these contracts have recognized the principle that small performance differences should not result in significant fee adjustments by providing a "null zone" (an interval around the point at which the performance of the investment company equals the performance of the index in which no performance fee adjustment, up or down, is payable). Other performance fee contracts decrease the significance of the payments made for slight performance differences through the use of continuous fees. 14/ Only four contracts failed to include either a null zone or a continuous fee.

Despite the recognition of the principle that significant fee adjustments should not be based upon small performance differences, the survey revealed several instances where the maximum fee adjustment (i.e., the amount added to the fulcrum fee which yields the largest total fee payable under the contract) could result from insignificant performance differences. Under a number of contracts the maximum fee adjustment resulted from any difference,no matter how slight, in performance between the fund and the index. Under other contracts performance differences were measured

12/ See Investment Advisers Act Release No. 316 .

13/ Under such contracts fee adjustments occur only after whole percentage point performance differences.

14/ Under contracts with continuous fees, payments increase or decrease with slight performance differences and fractional differences are usually prorated.

in terms of a percent of the investment performance of the index rather than in terms of percentage point differences. Using percent differences may result in a maximum fee adjustment for small absolute differences in performance.15/ Similarly, under a substantial number of contracts the maximum fee adjustment may result from a performance difference of less than 10 percentage points. Under other incentive fee arrangements, a significant portion of the maximum fee adjustment may also result from insignificant performance differences.

As a matter of elementary fairness the performance differences from which the maximum fee adjustment results should be set so as to preclude such maximum fee adjustment resulting from insignificant or random differences. Through a statistical analysis of the performance of the investment company relative to the performance of the index throughout the year, it is possible to determine whether or not the investment performance of the investment company differs significantly from the investment record of the index. Ideally, under any particular performance fee contract there should be at least a 90 percent probability that the maximum fee adjustment will not result from random fluctuations in performance.

Although the appropriate performance difference may vary from one investment company to another and from time to time, preliminary studies of the Division of Corporate Regulation indicate that as a "rule of thumb", the performance difference should be at least ± 10 percentage points in order to provide a 90 percent probability that the maximum fee adjustment will not result from random fluctuations or insignificant differences between the performance of the investment company and the index. 16/

15/ The percent method may tend to be a misleading indicator of small differences. For example, if the index increased by 1%, an investment company whose net asset value increased by 3% would outperform the index by 200%. This may be confusing since persons may tend to associate a much larger difference with a 200% difference. On the other hand, when there are large changes in the index, measuring differences in percents may prevent a performance fee adjustment even where a performance difference, expressed in percentage points, is substantial.

16/ A somewhat lower performance difference may be significant for large, well-diversifed, investment companies. For investment companies which are small or are not well-diversified a significantly higher performence difference than ± 10 percentage points would be required. This "rule of thumb" is based upon a measuring period of one year and the "investment record" of the S&P 500 Stock Composite Index.

Because of the preliminary nature of these studies, the Commission is not recommending, at this time, that any particular performance difference exist before the maximum fee adjustment may be made. 17/ However, investment company directors should consider what a significant performance difference would be under the incentive fee contracts of the investment companies they serve, taking into account the company's size, volatility (i.e., how the investment company's performance has changed in relation to that of the index over long and short term periods), diversification and variability of performance differences. They should satisfy themselves that the maximum performance adjustment will be made only for performance differences that can reasonably be considered significant.

Of course, similar considerations are required for fee adjustments that are less than the maximum. In other words, meaningful fee adjustments may occur at levels which are less than the maximum and therefore, like maximum adjustments, they should be based upon significant performance differences. 18/ This may be accomplished by the use of null zones of appropriate size or of a fee structure under which the effect of small performance differences is not proportionally greater than the effect of large performance differences.

By the Commission.

Ronald F. Hunt
Secretary

17/ The Division's studies applied standard statistical tests of significance to incentive fee contracts. The formula used by the Division will be made available to interested persons upon written request. The Commission would appreciate receiving comments with respect to it from interested persons, particularly those with technical expertise.

18/ The level of confidence that such lesser fee adjustments are based upon meaningful performance differences may be less than 90%.

FOR RELEASE Thursday, April 6, 1972

SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549

INVESTMENT COMPANY ACT OF 1940
Release No. 7113
INVESTMENT ADVISERS ACT OF 1940
Release No. 315

FACTORS TO BE CONSIDERED IN CONNECTION WITH INVESTMENT COMPANY ADVISORY CONTRACTS CONTAINING INCENTIVE FEE ARRANGEMENTS

The Securities and Exchange Commission today called the attention of all registered investment companies, their officers and directors and their investment advisers to certain factors which must be considered in connection with investment company incentive fee arrangements in view of the provisions of the Investment Company Amendments Act of 1970, Public Law 91-547 ("1970 Act").

Section 205 of the Advisers Act was amended by the 1970 Act in order to provide protection against performance fee arrangements which are unfair to investment companies. It prohibits all performance fees unless compensation under them increases and decreases proportionately with the investment performance of the company over a specified period in relation to the investment record of an appropriate index of securities prices or such other measure of investment performance as the Commission by rule, regulation or order may specify. The point from which increases and decreases in incentive compensation are measured must be the fee which is paid or earned when the investment performance of the company is equivalent to that of the index or other measure of performance.

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1/ The Commission has previously issued a release setting forth certain of its views with respect to the approval of advisory contracts under the 1970 Act (IC Release No. 6336, February 2, 1971) and another release setting forth certain views of its Division of Corporate Regulation respecting the fiduciary duties of directors under Section 36(a) of the 1970 Act (IC Release No. 6480, May 10, 1971).

Prior to the amendment of Section 205 many investment company performance fee arrangements were unfair to investment companies. Many incentive fees did not decrease for poor performance, or if they did, decreases were disproportionate to the increases. In addition, in some cases, the index against which investment company performance was measured was inappropriate and prejudicial to investment companies.

The Commission has surveyed the performance fee arrangements of registered investment companies in effect as of January 3, 1972, in order to evaluate such arrangements in view of the requirements of amended Section 205 of the Advisers Act and the fiduciary standards of the Investment Company Act. Of 999 management open-end and closed-end investment companies, 103 had performance fee arrangements on that date. The survey indicated that although many of the unfair features of previous performance fee arrangements have been eliminated, some performance fee arrangements still contain features which create bias against investment companies and do not conform to the provisions of Section 205 of the Advisers Act or the fiduciary standards of the Investment Company Act. These features include selection of an inappropriate index, computation of investment company average net assets and performance over different intervals and failure to reflect the reinvestment of dividends paid from investment income in computing investment company investment performance and of all cash distributions in computing the investment record of the index. 2/ As is explained below, these practices result in measuring investment company performance on a basis that is unfair to the investment company, and which does not relate to the investment record of the index.

The Commission is also concerned with incentive fee arrangements which permit significant fee adjustments based on random or insignificant differences rather than meaningful differences in the performance of the investment company and the index. This may occur, for example, where the maximum incentive fee or penalty is paid for the slightest performance difference or where significant performance fee adjustments are based on random or insignificant performance differences.

2/ Reinvestment means treating amounts distributed by an investment company as invested in shares of the investment company at the record dates of the distributions and treating amounts distributed by the companies which comprise the index as invested in the securities which comprise the index as soon as possible after their ex-dividend or record dates, rather than at the end of the measurement period. Such treatment gives proper effect to dividends and distributions during the measurement period.

The Fairness of the Fulcrum Fee

Any consideration of the fairness of a performance fee arrangement must start with the midpoint or "fulcrum fee" (the fee paid when the investment company's performance equals that of the index). The maximum and minimum incentive fee rates and all performance increments are measured from the fulcrum fee. Thus, the selection of a fair fulcrum fee is a critical prerequisite to a fair performance fee. This means that the same factors should be considered in arriving at a fair fulcrum fee as are taken into account in establishing the proper fee under advisory contracts which do not involve incentive compensation. 3/

Selection of an Appropriate Index

As indicated above, Section 205 requires that the investment performance of the investment company be measured against the investment record of an appropriate index of securities prices. In determining whether an index is appropriate for a particular investment company, directors should consider factors such as the volatility, diversification of holdings, types of securities owned and objectives of the investment company. For example, for investment companies that invest in a broad range of common stocks, a broadly based market value weighted index of common stocks ordinarily would be an appropriate index, 4/ but an index based upon a relatively few large "blue chip" stocks would not. For investment companies that invest exclusively in a particular type of security or industry, either a specialized index that adequately represents the performance of that type of security or a broadly based market value weighted index ordinarily would be considered appropriate. 5/ Of course, if an investment company invests in a particular type of security an index which measures the performance of another particular type of security would

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3/ The Report of the Committee on Interstate and Foreign Commerce of the House of Representatives on the 1970 Act states that "(T)he fiduciary duty with respect to management compensation contained in...new section 36(b) of the Act would apply to compensation received pursuant to a performance-related contract permitted by section 205 to the same extent as it does to other types of investment advisory contracts." H. Rep. 91-1382, p. 41 (91st Cong., 2nd Sess., August 7, 1970). See also S. Rep. 91-184, p. 45 (91st Cong., 1st Sess., May 21, 1969).

4/ See the Institutional Investor Study, Vol. 2, H. Doc. 92-64, 92nd Cong., 1st Sess. Pt. 2, March 10, 1971, p. 408.

5/ An index may be computed on a weighted or unweighted basis, but in no event should the index be weighted by fortuitous considerations such as the price per share. Certain averages which are weighted by price give greater weight to the stocks in the index having higher market prices. An effect of this is to give proportionately less weight to stocks after price appreciation leads to a stock split. These completely fortuitous considerations penalize growth and make such averages inappropriate, regardless of the type of securities held by the investment company, as a basis for comparison with investment company investment performance.

not be appropriate. 6/

Variations in Periods Used For Computing Average Asset Values and Performance

In computing compensation for incentive fee arrangements, variations in the time interval over which average asset value and investment performance are computed can make a significant difference. The larger the asset base, the greater the amount of compensation which will be added or deducted for performance and the more volatile performance compensation will be. For example, if average assets are based upon average daily assets over the last 3 months of a 36 month performance period (or the last month of an annual performance period) it is possible that, as a result of accumulated sales, there would be greater average assets than there would be if assets were averaged over the entire period. Thus, the amount of assets to which the performance fee rate would be applied would be greater. In effect, the use of the shorter period will have raised the "performance ante." Ironically, it will also cause the amount of compensation, which supposedly is paid for "performance", to be related significantly to the amount of sales. 7/

Section 205 of the Advisers Act requires that compensation be based on the asset value of the company averaged over a specified period and increasing and decreasing proportionately with the investment performance of the company over a specified period in relation to the investment record of an appropriate index of securities prices. The use of different periods for averaging assets and computing investment performance would be unfair to the investment company and would violate Section 205. 8/

6/ Technical methods for specifying incentive fees based upon risk or volatility adjusted returns are now being explored by the staff and a number of industry and academic groups as well as commercial enterprises. However, the Commission has not, at this time, arrived at any conclusions with respect to these methods.

7/ On the other hand, if performance has been poor, the impact of declining asset values and decreased sales could be greatest at the end of the period. This would tend to lower the asset base for investment companies which have had poor performance.

8/ Similarly, if the period over which net asset values are averaged for computing the fulcrum fee differs from the period over which net asset values are averaged for computing the performance related portion of the fee, it could result in incentive payments having a disproportionate relationship to the fulcrum fee. The Section 205 requirement that "compensation" be based upon the asset value of the company "averaged over a specified period" means that the same period must be used for computing average assets for the fulcrum fee and the performance fee segments of the adviser's compensation.

Length of Period over which Performance is Computed

Although Section 205 of the Advisers Act does not require that performance be measured over a period of any particular length, there is a fiduciary obligation to use an interval sufficiently long to provide a reasonable basis for indicating the adviser's performance. All 103 investment companies surveyed measured their performance over a period of at least one year. Use of at least a one year interval minimizes the possibility that payments will be based upon random or short term fluctuations.

Computation of Performance Over a "Rolling Period"

Over 43 percent of the companies surveyed (45 companies) measured their performance on the basis of a rolling period, a moving average of the number of subperiods (i.e., months or quarters) included in the full period over which performance is measured. Section 205 of the Advisers Act does not specify that either a rolling period or a flat period be used. However, there are a number of advantages, both from the shareholders' and the adviser's point of view, in using a rolling average.

For example, since Section 205 requires that performance be measured over a "specified period", in the absence of a specified fixed or rolling period, compensation cannot be precisely computed or paid until that period has expired and the investment company's performance for the entire period is known. In other words, interim payments based upon interim performance are not permissible under Section 205. 9/ Use of a rolling period for computation of a performance fee avoids the problem of interim payments. It permits payments based upon performance to be made more frequently than annually, since each payment would be based upon performance over the preceding twelve months or longer period adopted.

Rule 2a-4 under the Investment Company Act requires that investment company shares be sold at their approximate net asset value. To do this, amounts reflecting the performance fee must be accrued on a daily basis. Use of a rolling period avoids accruing a performance fee on the basis of periods of substantially less than one year and smoothes out accruals resulting from short term fluctuations in performance. For contracts computed on the basis of a period of one year or more, but without the use of a rolling period, accruals for the performance fee near the beginning of the period would be based upon periods of substantially less than a year. Under a rolling period contract, accruals for the performance fee can be computed on the basis of a period of at least 11 months or three quarters of a year (the time elapsed, depending upon the sub-periods adopted, when the daily accrual in the current computation period commences) and thus the effects on accruals of short-term performance would be minimized and accruals would better reflect overall performance and the fee ultimately payable.

9/ Of course, if a fee schedule provides for the payment of a minimum fee regardless of performance, interim payments based solely on the minimum fee would be permissible.

Performance Fee Transitional Periods

A difficulty arises in connection with the "start-up" or transitional period for performance fees when a performance fee is based upon a period for which investment results are already known or for which the adviser has already received compensation under the previous contract. To the extent that performance during the earlier period adds to the adviser's compensation, in essence he will be compensated twice for the same period and the same performance. Moreover, the investment company's positive performance during the period prior to adoption of the performance fee gives the adviser a "running start" on the index. If such an arrangement were permitted, the investment company would not have to outperform the index during the balance of the period covered by the performance fee in order that its adviser collect a performance fee. If the investment company merely maintained its relative performance for the balance of the specified period, the adviser nevertheless would collect a fee for "outperforming" the index. For example, if a 36 month rolling performance fee were adopted which included 18 months for which performance results were already known, and during which the performance of the investment company was greater than that of the index, the investment performance of the investment company could be the same as that of the index over the next 18 months but the adviser, nevertheless, would receive a performance fee for "outperforming" the index. Elementary fiduciary standards require that performance compensation be based only upon results obtained after such contracts take effect. In other words, a performance fee contract may be instituted on a prospective basis only. 10/

A transitional problem may also result if a contract containing an investment company performance fee arrangement is cancelled before its expiration date and the same adviser is rehired under a straight percentage of assets contract. Assume, for example, that an investment company's performance over the first half of the period specified in its contract is significantly worse than the investment record of the index and that it appears unlikely that the adviser will earn any incentive fee, or even the fulcrum fee, over the full term of the contract. It may be to the adviser's advantage to attempt to renegotiate his contract and to substitute a contract without a performance fee, but at a fee higher than that which it could earn under the original contract. Such substitution would be unfair to the investment company. If an adviser could cancel a performance contract during a period for which a performance fee is to be computed and recontract on a percentage of assets basis, such contracts would once again amount to the kind of "one way street" that existed prior to the enactment of Section 205. To prevent this, such a new contract should provide that the fee payable until the end of the performance fee computation period of the original contract shall be the lesser of the amount which would have been paid under the original contract or the amount payable under the new contract.

10/ Of course, under any performance fee arrangement incentive compensation is based upon results achieved over an earlier period. However, those results have not been determined before the contract is adopted.

Similarly, cancellation of a "rolling" performance fee contract during a period of substandard performance could be unfair to the investment company if a percentage of assets or different performance fee contract with the same adviser were substituted. The appropriate method of "winding down" a rolling performance fee contract would be to give the investment company substantial advance notice, (i.e., not less than half of the fee computation period specified in the contract) of the adviser's intention to cancel the contract and to provide that the fee payable during such "winding down" period shall be the lesser of the amount which would have been due under the original contract or the fee payable under the new contract.

Computation of the "Investment Performance" of the Investment Company and the "Investment Record" of the Index with Respect to Payment of Dividends from Investment Income and Distributions of Realized Capital Gains

As indicated in the Institutional Investor Study, the best measure of the total benefits received by investment company shareholders during a specified period is one that reflects changes in net asset value of the company's shares with adjustments to compensate for the payment of any realized capital gains distributions and dividends from investment income during the evaluation period. This measure gives effect to all increments in value received by stockholders and has been widely used without any serious challenge to its propriety. 11/

Section 205 of the Advisers Act requires that compensation increase and decrease proportionately based upon investment performance of the investment company in relation to the investment record of the index, as distinguished from the index price. In 93 percent of investment companies with performance fee arrangements capital gains distributions were treated as reinvested in computing investment performance. Such reinvestment is necessary in order that investment company performance be computed on the same basis as the index, since capital gains are neither realized nor distributed with respect to the companies comprising the index. Unless investment company capital gains distributions are treated as reinvested in computing investment company investment performance, such performance would not relate to the investment record of the index.

Similarly, dividends paid from investment income on investment company shares and cash distributions on the securities which comprise the index are significant factors which cannot be overlooked in computing the "investment record" of the index and in relating investment

11/ Institutional Investor Study Report, Vol. 2, H. Doc. 92-64, 92nd Cong., 1st Sess. Part 2, March 10, 1971, p. 409.

company investment performance to that investment record. On the average, the dividends paid from investment income by investment companies with performance fee arrangements have been less than the cash dividends paid on the securities of the companies which comprise the indices used in performance comparisons. Thus, in many cases, ignoring dividends and any other cash distributions in relating investment company investment performance to the investment record of the index can give investment advisers a substantial advantage.

To correct this, the Commission, pursuant to its authority under Sections 205 and 211 of the Advisers Act, has proposed rules defining the terms "investment performance" and "investment record" as they are used in Section 205 of that Act 12/to make clear that such provision requires inclusion of dividends paid from investment income and realized capital gains distributions of the investment company and of cash distributions on the securities of companies which comprise the index.

Avoid Basing Significant Fee Adjustments upon Random or Insignificant Differences

In structuring incentive fee arrangements it is important to build in a degree of confidence that any significant incentive payments (or penalties) are attributable to the adviser's skill, or lack of skill, rather than to random fluctuations. Most investment company incentive fee contracts have "step rates". 13/ Generally, these contracts have recognized the principle that small performance differences should not result in significant fee adjustments by providing a "null zone" (an interval around the point at which the performance of the investment company equals the performance of the index in which no performance fee adjustment, up or down, is payable). Other performance fee contracts decrease the significance of the payments made for slight performance differences through the use of continuous fees. 14/ Only four contracts failed to include either a null zone or a continuous fee.

Despite the recognition of the principle that significant fee adjustments should not be based upon small performance differences, the survey revealed several instances where the maximum fee adjustment (i.e., the amount added to the fulcrum fee which yields the largest total fee payable under the contract) could result from insignificant performance differences. Under a number of contracts the maximum fee adjustment resulted from any difference,no matter how slight, in performance between the fund and the index. Under other contracts performance differences were measured

12/ See Investment Advisers Act Release No. 316 .

13/ Under such contracts fee adjustments occur only after whole percentage point performance differences.

14/ Under contracts with continuous fees, payments increase or decrease with slight performance differences and fractional differences are usually prorated.

in terms of a percent of the investment performance of the index rather than in terms of percentage point differences. Using percent differences may result in a maximum fee adjustment for small absolute differences in performance.15/ Similarly, under a substantial number of contracts the maximum fee adjustment may result from a performance difference of less than 10 percentage points. Under other incentive fee arrangements, a significant portion of the maximum fee adjustment may also result from insignificant performance differences.

As a matter of elementary fairness the performance differences from which the maximum fee adjustment results should be set so as to preclude such maximum fee adjustment resulting from insignificant or random differences. Through a statistical analysis of the performance of the investment company relative to the performance of the index throughout the year, it is possible to determine whether or not the investment performance of the investment company differs significantly from the investment record of the index. Ideally, under any particular performance fee contract there should be at least a 90 percent probability that the maximum fee adjustment will not result from random fluctuations in performance.

Although the appropriate performance difference may vary from one investment company to another and from time to time, preliminary studies of the Division of Corporate Regulation indicate that as a "rule of thumb", the performance difference should be at least ± 10 percentage points in order to provide a 90 percent probability that the maximum fee adjustment will not result from random fluctuations or insignificant differences between the performance of the investment company and the index. 16/

15/ The percent method may tend to be a misleading indicator of small differences. For example, if the index increased by 1%, an investment company whose net asset value increased by 3% would outperform the index by 200%. This may be confusing since persons may tend to associate a much larger difference with a 200% difference. On the other hand, when there are large changes in the index, measuring differences in percents may prevent a performance fee adjustment even where a performance difference, expressed in percentage points, is substantial.

16/ A somewhat lower performance difference may be significant for large, well-diversifed, investment companies. For investment companies which are small or are not well-diversified a significantly higher performance difference than ± 10 percentage points would be required. This "rule of thumb" is based upon a measuring period of one year and the "investment record" of the S&P 500 Stock Composite Index.

Because of the preliminary nature of these studies, the Commission is not recommending, at this time, that any particular performance difference exist before the maximum fee adjustment may be made. 17/ However, investment company directors should consider what a significant performance difference would be under the incentive fee contracts of the investment companies they serve, taking into account the company's size, volatility (i.e., how the investment company's performance has changed in relation to that of the index over long and short term periods), diversification and variability of performance differences. They should satisfy themselves that the maximum performance adjustment will be made only for performance differences that can reasonably be considered significant.

Of course, similar considerations are required for fee adjustments that are less than the maximum. In other words, meaningful fee adjustments may occur at levels which are less than the maximum and therefore, like maximum adjustments, they should be based upon significant performance differences. 18/ This may be accomplished by the use of null zones of appropriate size or of a fee structure under which the effect of small performance differences is not proportionally greater than the effect of large performance differences.

By the Commission.

Ronald F. Hunt
Secretary

17/ The Division's studies applied standard statistical tests of significance to incentive fee contracts. The formula used by the Division will be made available to interested persons upon written request. The Commission would appreciate receiving comments with respect to it from interested persons, particularly those with technical expertise.

18/ The level of confidence that such lesser fee adjustments are based upon meaningful performance differences may be less than 90%.

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 1-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 Dada
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 Indicies 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

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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

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 is 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.

INVESTIGATIVE PROCEEDING

Hearing Officer:

On the record at _____, ___.m., _____ _____, 1972.

Mr. _____, this is a non-public proceeding by the United States Securities and Exchange Commission into the matter _____ Company. As is customary in proceedings of this kind, I wish to advise you as follows:

This investigation is being conducted pursuant to an order of investigation entered by the Commission on _____ _____, 1972, directing investigation of _____ Company, transactions in its securities and related matters and persons. The purpose of this investigation is to ascertain whether there have been violations of Sections 5 and 17 of the Securities Act of 1933, and violations of Section 10(b) and Rule 10b-5 thereunder, of the Securities Exchange Act of 1934. For your information, Section 5 of the 1933 Act is the securities registration section, and Sections 17 of the 1933 Act and 10(b) of the 1934 Act are securities fraud provisions.

The facts developed in this investigation might constitute violations of other State and Federal statutes as well as those I have just mentioned. Under the Commission's Rules

relating to Investigations you are permitted to be represented by counsel of your choice.

(a) I notice that you do have an attorney here today . . . is that correct? Is he the attorney of your choice?

Would your counsel enter his appearance of record?

Let the record also reflect presence of _____

_____, _____,

and my name is _____, an attorney with the LARO of the S.E.C.

(b) I note that you do not have an attorney present with you today. Inasmuch as this matter could involve serious violations of law, we want to give you the opportunity to consult or have counsel present if you so desire. With that in mind, do you wish to proceed at this time? _____ Very well. If, however, you wish to halt this interview in order to consult with counsel, please advise me.

Mr. _____, any evidence you give may be used against you in any future proceeding, including civil, administrative and criminal actions. You may refuse to give any testimony or produce any personal documents which may tend to incriminate you or subject you to fine, penalty or forfeiture which is a right provided by the 5th Amendment to

the Constitution. Do you understand your rights?

(If the witness appears voluntarily, not pursuant to subpoena, he should be told that his testimony is voluntary, he has a right to remain silent and as such may refuse to answer any question without offering any explanation and may leave the hearing room, indeed the offices of the Commission, at any time).

You should be advised that under Title 18, Section 1001 of the United States Code, it is a crime to knowingly make any false statement to a Federal officer. For the purpose of this interview, Mr. _____ and I are Federal officers. Since you are under oath any material false statement may also constitute the crime of perjury which is a felony under Federal laws.

Do you understand the nature of these proceedings and your constitutional rights?

Would you rise to be sworn?

Would you state your full name, please.

Demand subpoenaed documents by reading each category of documents from the subpoena, and inspect each document as it is produced, and identify it in the record.

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INTRODUCTION

This book contains sample charges for use in orders for administrative proceedings to be brought as a result of violations of the Securities Act of 1933 and the Securities Exchange Act of 1934 and the rules under these acts.

There are three parts to the book. Part I covers violations other than fraud. Part II covers charges of fraud. Part III covers miscellaneous items. The appendices contain the full text of certain orders used in back office cases, three insider trading cases and the Pickard case. The latter is included because of the numerous violations involved. The Pickard case does contain charges of violations of Exchange Act Rule 15C1-2. Charges of violation of Rule 15C1-2 are no longer used.

We note here also that in broker-dealer cases, with certain exceptions, it is not necessary to incorporate a jurisdictional charge (see 34 act section 15b4).

Changes have been made relating to Regulation T of the Board of Governors of the Federal Reserve System. This book will later be amended to include any new charges required by those changes.

It is hoped this book can periodically be updated. We would appreciate suggestions as well as copies of orders containing new charges.

Division of Trading and Markets
October 1969

As amended March 1971

PART I

Contents

Sample Charges for Administrative Proceeding Orders
Charging violations of the Securities Act of 1933 and
the Securities Exchange Act of 1934 and Rules thereunder

PART II

FRAUD

Part III - Miscellaneous

Sample Charges for Administrative Proceeding Orders

SECURITIES ACT OF 1933

A. Unregistered Securities - Section 5(a) and (c) of Of 1933 Act

During the period from on or about to on or about registrant wilfully violated Section 5(a) and 5(c) of the Securities Act of 1933 (Securities Act) in that he, directly and indirectly, made use of the means and instruments of transportation and communication in interstate commerce and of the mails to offer to sell, sell and deliver after sale shares of the common stock of XYZ Corp. when no registration statement was filed or/ in effect as to said securities pursuant to the Securities Act. (Pickard & Co. - 8/68) (incorporates jurisdictional language)

- or -

During the period from approximately to respondent wilfully violated and wilfully aided and abetted violations of Sections 5(a) and 5(c) ot the Securities Act of 1933 (Securities Act) in that he offered to sell, sold and delivered after sale shares of the common stock of XYZ Corp. when no registration statement was in effect as to said securities pursuant to the Securities Act. (Max Blauner-6/68) (Jurisdiction to be pleaded separately)

B. Insufficient and Inadequate Prospectus - Section 5(b)(1) of 1933 Act

During the period from about to A and B wilfully violated and wilfully aided and abetted violations of Section 5(b) of the

Securities Act of 1933 ("Securities Act") in that **said persons directly and** indirectly, carried and caused to be carried through the mails and in interstate commerce the common stock of **XYZ Corp.** for the purpose of sale and for delivery after sale without such security being accompanied or preceded by a prospectus **meeting** the requirements of subsection (a) of Section 10 of the Securities Act. **(Greene & Co. et.al. - 3/66)**

C. TOUTING - COMMUNICATION DESCRIBING SECURITY WITHOUT DISCLOSING CONSIDERATION RECEIVED OR TO BE RECEIVED 33 ACT 17b

From January 1, 1962 to January 3, 1963, registrant wilfully violated and Doe and Roe wilfully aided and abetted violations of the Securities Act in that they, by the use of means and instruments of transportation and communication in interstate commerce and by use of the mails, published, gave publicity to, and circulated an article entitled "To The Groom" describing the securities of XYZ and TUV, for a consideration received and to be received from XYZ and TUV, without fully disclosing such past and prospective consideration and the amount thereof.

SECURITIES AND EXCHANGE ACT OF 1934

A - Margin, Credit, Regulation T

1. Member firms

During the period from on or about to on or about registrant, while transacting a business in securities as a member of a national securities exchange, wilfully violated and A wilfully aided and abetted violations of Section 7(c)(1) of the Exchange Act in that registrant, directly or indirectly, extended and maintained credit and arranged for the extension and maintenance of credit to and for customers on securities (other than exempted securities) registered on a national securities exchange, and on collateral other than securities registered on a national securities exchange, in contravention of Section 3 and 4 of Regulation T adopted by the Board of Governors of the Federal Reserve System pursuant to Sections 7(a) and 7(b) of the Exchange Act. (Pickard & Co.-8/68)

2. Special Cash Account - 7-day Rule

During the period from on or about to date Registrant, while a member of a national securities exchange, wilfully

violated Section 7(c)(1) of the Exchange Act and the rules and regulations which the Board of Governors of the Federal Reserve System prescribed thereunder in that Registrant, directly and indirectly, extended, maintained and arranged for credit to and for customers on securities (other than exempted securities) in contravention of the aforesaid rules and regulations. As part of the aforesaid conduct and activities, registrant, among other things, failed to promptly cancel or otherwise liquidate the transactions or unsettled portions thereof of customers who purchased securities (other than exempted securities) in special cash accounts and did not make full cash payment for the securities within 7 days after the date on which the security was so purchased. **(Estabrook-7/68, Kelly & Morey-8/68)**

3. General Account - 5-day rule

During the period from on or about to date Registrant while a member of a national securities exchange, wilfully violated Section 7(c)(1) of the Exchange Act and the rules and regulations which the Board of Governors of the Federal Reserve System prescribed thereunder in that they effected for and with customers in general accounts transactions which, in combination with other transactions effected in each account on the same day, created or increased excesses of the adjusted debit balances over the maximum loan value of the securities in each account, without obtaining before the expiration of five full business days following the date of each such transaction, deposits of cash or securities in such amounts that in each such account the cash deposited plus the maximum loan value of the securities deposited equalled or exceeded the excesses so created or the increases so caused; such conduct failing to comply with Section 3(b)(i) of Regulation T.

4. General Account - Withdrawals below minimum margin requirements

During the period from on or about to date Registrant, while a member of a national securities exchange, wilfully violated Section 7(c)(1) of the Exchange Act and the rules and regulations which the Board of Governors of the Federal Reserve System prescribed thereunder in that they allowed customers to withdraw cash or securities from general accounts causing the adjusted debit balances of each such account to be less than the maximum loan value of the securities in the account after such withdrawal; such conduct failing to comply with Section 3(b)(2) of Regulation T.

5. Special Accounts - Improper handling

During the period from on or about to date Registrant, while a member of a national securities exchange, wilfully violated Section 7(c)(1) of the Exchange Act and the rules and regulations which the Board of Governors of the Federal Reserve System prescribed thereunder in that they established special accounts for customers without recording each such special account separately, without confining each such special account to the transactions and relations specifically authorized for such account by Section 4 of Regulation T and to transactions and relations incidental to those specifically authorized, and without maintaining adequate records showing for each such account the full details of all transactions in the account; such conduct failing to comply with Section 4(a)(2) of Regulation T.

B- HYPOTHECATION OF SECURITIES - SECTION 8(c)

During the period from on or about to on or about 1 registrant wilfully violated, and A wilfully aided and abetted violations of Sections 8(c) and 15(c)(2) of the Exchange Act and Rules 8c-1(a) and 15c2-1 thereunder in that registrant in effecting transactions in securities, directly and indirectly, hypothecated, arranged for and permitted the continued hypothecation of securities carried for the accounts of customers under circumstances in which (1) securities carried for the accounts of customers were commingled with securities carried for the accounts of other customers, without the prior written consent of each such customer; (2) such securities were commingled with securities **carried for the accounts of persons other than bona fide customers of** registrant under a lien for a loan to registrant; and (3) securities carried for the accounts of customers were hypothecated and subjected to liens of pledgees for a sum in excess of the aggregate indebtedness of such customers in respect of such securities. **(Pickard & Co. 8/68)**

C- MANIPULATION OF PRICES

1. Listed Securities

During the period from on or about to on or about , A wilfully violated and registrant wilfully aided and abetted violations of Section 9(a)(2) of the Exchange Act in that said persons, directly and indirectly, singly and in concert, through the use of the facilities of a national securities exchange effected a series of transactions in the common stock of **XYZ Corp.** , such transactions

creating actual and apparent active trading in such securities for the purpose of inducing the purchase and sale of such securities by others. (Pickard & Co. 8/68)

From to registrant wilfully violated and Doe and Roe wilfully aided and abetted violations of Section 9(a) of the Exchange Act in that they, directly and indirectly, by the use of the mails and means and instrumentalities of interstate commerce and facilities of the New York Stock Exchange [or, while registrant was a member of the New York Stock Exchange]:

9(a)(1) (1) for the purpose of creating a false and misleading appearance of active trading in and of the market for XYZ stock, a security registered on the New York Stock Exchange:

a. effected transactions in XYZ stock which involved no change in the beneficial ownership thereof;

or

9(a)(1) b. entered orders for the purchase (or sale) of XYZ stock with knowledge that orders of substantially the same size, at substantially the same time, and at substantially the same price, for the sale (or purchase) of such XYZ stock, had been entered by (or for) registrant, Doe and Roe (or by others);

or

9(a)(2) (2) effected (with Smith and DEF) a series of transactions in XYZ stock, a security registered on the New York Stock Exchange, creating actual and apparent active trading in such security; and raising (or depressing) the price of such security, for the purpose of inducing the purchase (or sale) of such security by others;

or

9(a)(3) While offering for sale (or purchasing or offering to purchase) XYZ stock, a security registered on a national securities exchange, induced by the circulation or dissemination in the ordinary course of business of information to the effect that the price of such stock would or was likely to rise (or fall) because of market operations of such persons conducted for the purpose of raising (or depressing) the price of such stock.

or

9(a)(4) made, regarding XYZ stock, a security registered on the New York Stock Exchange, for the purpose of inducing the purchase (or sale) of XYZ stock, statements which were at the time and in the light of the circumstances which they were made, false and misleading with respect to material facts, and which registrant, Doe and Roe knew or had reasonable grounds to believe were false and misleading, concerning, among others:

or

9(a)(5) (for a consideration received directly of indirectly from Smith and DEF) induced the purchase (or sale) of XYZ stock, a security registered on the New York Stock Exchange, by the circulation and dissemination in the ordinary course of business of information to the effect that the price of XYZ stock will or is likely to rise (or fall) because of market operations of registrant, Doe and Roe (or Smith, DEF or others) conducted for the purpose of raising (or depressing) the price of such security;

(any misrepresentations or "half-truths")

D- SHORT SALES, STOP LOSS ORDERS

Fail to Mark Orders "long" or "short"

1- effect for Mace's own account and for the account of others, short sales of the common stock of Mary Carter on the American Stock Exchange below the price at which the last sales thereof, regular way, were effected on such exchange, and effected short sales at the same price as the last sale price, regular way, when such last price was not above the next preceding different price at which a sale of such security, regular way, was effected on such exchange; and

2- use the facilities of a national securities exchange to execute sell orders marked "long" when in fact such sell orders were "short".

Registrant and Mace violated and wilfully aided and abetted violations of Section 10(a) of the Exchange Act and Rule 17 CFR 240.10a-1, thereunder, by means and in the manner described in paragraphs and hereof. (Delafield & Delafield 11/21/68)

E- BIDDING OR PURCHASING DURING DISTRIBUTION

During the period from about to about respondent wilfully violated and **Doe wilfully aided and abetted violations** of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-6 thereunder in that while participating in a distribution of the common stock of **XYZ Corp. they bid for and purchased such securities for accounts in** which he had a beneficial interest and induced other persons to purchase such securities prior to completing said distribution. **(Max Blauner 6/68)**

or

From to registrant wilfully violated and and wilfully aided and abetted violations of Section 10(b) of the Exchange Act and Rule 10b-6 thereunder in that they used, in connection with the purchase and sale of securities, manipulative and deceptive devices and contrivances, and in connection therewith registrant, Doe and Roe, who were underwriters in a distribution of XYZ securities (or, who were the issuers or other persons on whose behalf such a distribution was being made; or, who is a broker, dealer or other person who agreed to participate in such a distribution), directly and indirectly, by the use of means and instrumentalities of interstate commerce, and of the mails (and of facilities of a national securities exchange), (with one or more other persons) bid for and purchased for accounts in which they had a beneficial interest) XYZ securities which were the subject of such **distribution**, prior to the completion of the participation of registrant, Doe and Roe in such distribution. **(includes jurisdictional language)**

F- UNREGISTERED BROKER-DEALER - SECTION 15(a)

1. During the period from about to , registrant wilfully violated and B & B wilfully aid and abetted violations of Section 15(a) of the Exchange Act in that said persons acted and conducted business as a broker-dealer in securities and as such made use of the mails and means and instrumentalities of interstate commerce to effect transactions in and to induce the purchase and sale of securities (other than exempted securities or commercial paper) otherwise than on a national securities exchange without being registered with the Commission in accordance with Section 15(b) of the Exchange Act. As a part of the aforesaid transactions, activities, and courses of conduct, respondents would and did:

(1) purchase and sell securities for their own account and for the accounts of others;

(2) arrange for and engage in the private placement of securities for their own account and for the accounts of others;

(3) arrange for and engage in the underwriting and distribution of securities including those securities listed below:

(4) extend and arrange for the extension of credit to customers and other persons in connection with the purchase of securities;

(5) collect and disburse dividends to and on behalf of customers and other persons;

(6) arrange for the transfer of ownership of securities for customers and other persons;

(7) loan and pledge securities to and on behalf of customers and other persons;

(8) render other services and engage in other activities and conduct common to those engaged in by brokers and dealers in securities.

2. Respondent from on or about _____ to the present wilfully aided and abetted XYZ Corp. in violation of Section 15(a) of the Exchange Act, in that respondent wilfully aided and abetted XYZ Corp, who was engaged in the business of a broker-dealer in securities (other than one whose business is exclusively intrastate), in its effecting transactions in and inducing purchases and sales of securities (other than exempted securities or commercial paper, bankers' acceptances or commercial bills) otherwise than on a national securities exchange, without its being registered in accordance with Section 15(b) of the Exchange Act. (Gloria Clapp - 6/68)

G- BROKER-DEALER APPLICATIONS - SECTION 15(b)

1. Application Inaccurate or incomplete

Respondent from on or about _____ to the present wilfully violated and wilfully aided and abetted _____ in violating Section 15(a) of the Exchange Act, in that respondent filed an application for registration as a broker-dealer with the Commission on Form BD that contained inaccurate statements that:

(a) no person connected with registrant is permanently enjoined from engaging in and continuing certain conduct and practices in connection with the purchase and sale of securities, when in fact Doe and Roe had been so enjoined by the United States District Court for the Southern District of New York on _____.

(b) No person other than those named in registrant's application for registration and the amendments and supplements thereto directly or indirectly controlled registrant's business, when in fact John Smith did directly or indirectly control registrant's business.

(c) (any other inaccurate statement contained in Form BD and the amendments thereto.)

2. False Financial Information Reported

On or about _____, Registrant wilfully violated Section 15(b)(1) of the Exchange Act and Rule 15b1-2 thereunder, in that Registrant filed, with the Commission as part of his application for registration as a broker-dealer, a statement of Financial Condition dated as of _____, which was false and misleading with respect to material facts, in that such Statement of Financial Condition overstated Registrant's net worth and failed to state a liability. (Hoover - 5/68)

3. Failure Promptly to Amend

From _____ to the present, registrant wilfully violated and Doe and Roe wilfully aided and abetted violations of **Section 15(b) of the Exchange Act and Rule 15b3-1 thereunder,** in that they:

(1) failed to promptly file with the Commission an amendment on Form BD reflecting that:

(a) Doe had become a 10% or more stockholder of registrant;

(b) John Smith, a salesman for registrant, was enjoined from engaging in and continuing certain conduct and practices in connection with the purchase and sale of securities by the United States District Court for the Southern District of New York on _____.

(c) Roe had become a vice-president of registrant;

(d) Registrant had changed the address of its principal place of business to 29 G Street, N. W., Washington, D. C.

(e) (any other information necessary to prevent the Form BD on file along with the supplements and amendments thereto from becoming inaccurate or incomplete for any reason.)

4. Amendment Inaccurate

During the period from on or about _____ to on or about _____, registrant wilfully violated, and _____ _____ and _____ wilfully aided and abetted violations of Section 15(b)(1) of the Exchange Act and Rule 15b3-1 thereunder in

that registrant omitted to disclose in amendments to its Form BD filed with the Commission that certain persons were owners of 10% or more of its equity securities and failed to promptly amend its Form BD with respect to changes in its officers and directors. (Pickard 8/68)

5. Withdrawal Application False

Registrant wilfully violated Section 15(b), 5(a) of the Exchange Act in that on _____ registrant filed a Notice of Withdrawal from registration, as a broker-dealer with the Commission on Form BDW and made or caused to be made in such Notice of Withdrawal statements which were at the time and in the light of the circumstances under which they were made false and misleading with respect to material facts and omitted to state in such notice material facts which were required to be stated therein in that:

(1) it contained a denial that registrant was involved in any legal action or proceeding when in fact law suits, involving securities transactions, were filed and pending against registrant as of the date the Form BDW was filed with the Commission;

(2) it contained a denial that there were any unsatisfied judgments or liens against registrant when in fact two attachment liens, eminating from the above law suits, have been filed against his property.

(3) it did not disclose that registrant owed money to customers when in fact registrant is indebted to several customers in a total in excess of _____ for funds of customers which registrant converted to his own use.

(Polycarpo 8/68)

6 . SECO Form False

On _____ registrant, which had been registered with the Commission for at least 45 days prior to _____ as a broker-dealer and which was not a member of a national securities association, wilfully violated and respondents wilfully aided and abetted such violations of Section 15(b)(9) of the Exchange Act and Rule 15b9-1 thereunder, in that registrant filed with the Commission its Form SECO-4-67 which was false and misleading in that it understated the number of such associated persons of registrant, as defined in Rule 15b8-1, by at least twenty-three (23) persons, and understated the amount of fees to be paid therefore by at least $115.00 and underpaid the fee required of registrant under Rule 15b9-1 for such associated persons by at least that amount. **(Associated Securities 3/68)**

H - NET CAPITAL DEFICIT OR DEFICIENCY (Rule 15c3-1)

During the period from on or about _____ to on or about _____ Registrant wilfully violated and _____ wilfully aided and abetted in the violation of Section 15(c)3 of the Exchange Act and Rule 15c3-1 thereunder in that Registrant made use of the mails and means and instrumentalities of interstate commerce to effect transactions in and to induce and attempt to induce the purchase and sale of securities (other than an exempted security or commerical paper, bankers' acceptances, or commercial bills) otherwise than on a national securities exchange when Registrant's aggregate indebtedness to all other persons exceeded 2,000 per centum of its net capital and Registrant did not have and did not maintain net capital of not less than $5,000. (Kelly & Morey 8/68

NOTE: NET CAPITAL

A net capital "deficit" means that a broker-dealer's net capital is a negative figure; whereas a net capital "deficiency" means that a broker-dealer's net capital is a positive figure, but does not equal or exceed 1/20 of aggregate indebtedness.)

H-1 FAILURE TO NOTIFY CUSTOMER OF FREE CREDIT BALANCE (RULE 15c3-2)

Use funds arising out of free credit balances carried for the accounts of customers in connection with the operation of registrant's business, but fail to give or send to each customer for whom a free credit balance is carried, together with or as a part of each such customer's statement of account at least once every three months, a written statement informing each such customer of the amount due to the customer by registrant on the date of such statement, and containing a written notice that:

(1) such funds are not segregated and may be used in the operation of registrant's business; and

(2) such funds are payable on the demand of the customer; such conduct failing to comply with Rule 15c3-2.

BOOKS AND RECORDS, BROKER-DEALER - SECTION 17(a)

(1) REFUSAL TO PRODUCE FOR COMMISSION INSPECTION

From _ _ _ _ _ _ _ _ to _ _ _ _ _ _ _ _ , registrant, wilfully violated and Doe & Roe wilfully aided and abetted violations of Section 17(a) of the Exchange Act in that registrant, Doe and Roe, failed and refused to produce for reasonable periodic, special and other examinations by examiners and other representatives of the Commission, the following books and records;

(2) FALSE ENTRIES IN - RULE 17a-3

During the period from on or about _ _ _ _ _ _ _ to on or about _____, willfully violated and _____ willfully aided and abetted violations of Section 17(a) of the Securities Exchange Act of 1934 and Rule 17a-3 thereunder in that _ _ _ _ _ _ made false entries in certain of its books and records to conceal payments made by _ _ _ _ _ _ _ _ to other broker-dealers. (Filor Bullard 6/68)

(3) FAILURE ACCURATELY TO MAKE AND KEEP - RULE 17a-3

During the period from on or about _ _ _ _ _ _ _ _ to date, Registrant willfully violated Section 17(a) of the Exchange Act and Rule 17a-3 thereunder in that Registrant failed to accurately make and keep current certain of its books and records including, but not by way of limitation: (Lehman Bros.)

(a) Blotters (or other records of original entry) containing an itemized daily record of purchases and sales of securities, receipts and deliveries of securities (including certificate

numbers), receipts and disbursements of cash and other debits and credits.

(b) Ledgers (or other records) reflecting all assets and liabilities, income and expense and capital accounts.

(c) Ledger accounts (or other records) itemizing separately as to each cash and margin account of every customer and of registrant and partners thereof, all purchases, sales receipts, and deliveries of securities and commodities for such account and other debits and credits to such account.

(d) Ledgers (or other records) reflecting the following:

(1) securities in transfer;

(2) dividends and interest received;

(3) securities borrowed and securities loaned;

(4) monies borrowed and monies loaned (together with a record of the collateral therefor and any substitutions in such collateral);

(5) securities failed to receive and failed to deliver.

(e) Securities record or ledger reflecting separately for each security as of the clearance dates all "long" or "short" positions (including securities in safekeeping) carried by registrant for its account or for the account of its customers or partners and showing the location of all securities long and the offsetting position to all securities short and in all cases the name or designation of the account in which each position is carried.

(f) Memoranda of each brokerage order, and instruction, given or received for the purchase or sale of securities.

(g) Memoranda of each purchase and sale of securities for the account of registrant.

(h) Copies of confirmations of all purchases and sales of securities.

(i) Records in respect of each cash and margin account with registrant containing the name and address of the beneficial owner of such account and, in the case of a margin account, the signature of such owner.

(j) A record of all puts, calls, spreads, straddles and other options.

(k) A record of the computation of aggregate indebtedness and net capital as of the trial balance date in accordance with the capital rules of at least one of the national securities exchanges of which registrant is a member.

(l) A properly executed questionnaire or application for employment for each associated person of registrant. Registrant and Albert G. Redpath failed reasonably to supervise persons under their supervision with a view to preventing the violations alleged in paragraph _ _ _ _ of Section _ _ of this Order.

(4) FAILURE TO PRESERVE - RULE 17a-4

Respondent wilfully violated and _____ willfully aided and abetted violations of Section 17(a) of the Exchange Act and Rules 17a-4 thereunder in that _ _ _ _ _ _ _ _ failed to preserve such accounts, correspondence, memoranda, papers, books and other records as are required to be preserved pursuant to the aforementioned Section and Rule. (Mencher 8/68)

(5) FAILURE TO FILE REPORT OF FINANCIAL CONDITION - RULE 17a-5

Registrant wilfully violated Section 17(a) and Rule 17a-5 thereunder in that registrant failed to file with the Commission a report of his financial condition for the calendar year 19_ _ as required by said Rule. (Polycarpo 8/68)

Broker Dealer's Annual Financial Report: §17a of 1934 Act, Rule 17a-5

Registrant wilfully violated and Doe and Roe wilfully aided and abetted violation of Section 17(a) of the Exchange Act and Rule 17a-5 thereunder:

1. During the period from on or about January 18, 1968, to May 8, 1968, Registrant wilfully violated and James P. Rahilly and Reuben Indursky vilfully aided and abetted violations of Section 17(a) of the Exchange Act and Rule 17a-5 thereunder in that Registrant failed to file with the Commission a report of financial condition as of a date not less than one month, nor more than 5 months, after the date on which Registrant became registered with the Commission. (Rahilly & Co., Inc. 12/19/68)
2. in that the report of financial condition filed by registrant on Form X-17a-5 on _____:

    a. is deficient in content and form in that it was not certified by a certified public accountant or a public accountant;

    b. contains false and misleading written, sworn statements by registrant as to:

        (1) the limitations of registrant's business as a basis for claiming an exemption from the requirement for certification of the report of financial condition;

        (2) the truth and correctness of the financial statement and supporting schedules; and

        (3) the proprietary interests of registrant and its associated persons in accounts classified solely as those of customers.

* * *

Registrant wilfully violated and _____, _____ and _____ wilfully aided and abettted violations of Section 17(a) of the Exchange Act and Rule 17a-5 thereunder in that registrant failed to file with the Commission a report of financial condition duly certified containing the information required by Form X-17A-5 for the calendar year 19__ within the time required by Rule 17a-5. (Pickard & Co. 8/68)

(6) FALSE REPORT OF FINANCIAL CONDITION - RULE 17a-5

Registrant wilfully violated Section 17(a) of the Exchange Act and Rule 17a-5 thereunder, in that Registrant filed with this Commission on _ _ _ _ _ _ _ _ 19 _ _ , and _ _ _ _ _ _ _ _ 19_ _ , reports of financial condition on Form X-17A-5, dated as of _ _ _ _ _ _ _ _ 19 and _ _ _ _ _ _ _ _ 19 _ _ , respectively, which reports were false and misleading with respect to material items, in that such reports failed to state moneys owed by Registrant to _ _ _ _ _ _ _ _ _ and to _ _ _ _ _ _ _ _ _ and the report of _ _ _ _ _ _ _ 19_ _ falsely stated that subordinated capitol in an amount sufficient to bring registrant into compliance with the Commission's net capital rule had been provided to registrant. (Hoover 5/68)

(7) FAILURE TO FILE CERTIFIED REPORT OF FINANCIAL CONDITION, WITHIN TIME REQUIRED, AS EXTENDED - RULE 17a-5

Registrant wilfully aided and abetted by _ _ _ _ _ _ _ _ _ _ , wilfully violated Section 17(a) of the Exchange Act and Rule 17a-5 thereunder in that (1) registrant failed to file with the Commission a report of financial condition for the year 19_ _ within the time required by Rule 17a-5(a) as extended under Rule 17a-5(d); and (2) such report of financial condition when filed on _ _ _ _ _ _ _ _ was not duly certified in accordance with Rule 17a-5(g).

(Schwabacker 7/68)

FRAUD

A. GENERAL CHARGES

1. 1933 Act - Section 17(a)

Registrant, Doe and Roe, wilfully violated and wilfully aided and abetted violation of Section 17(a) of the Securities Act of 1933 in that they offered and sold securities by the use of means and instruments of transportation and communication in interstate commerce and by the use of the mails, directly and indirectly employed devices, schemes and artifices to defraud, obtained money and property by means of untrue statements of material facts and omissions to state material facts necessary in order to make the statements made in the light of the circumstances under which they were made, not misleading, and engaged in transactions, practices and courses of business which operated and would operate as a fraud and deceit upon the purchasers and prospective purchasers of such securities. As a part of the aforesaid conduct, registrant, Doe and Roe would and did, among other things --

2. 1933 ACT, SECTION 17(a) - 1934 ACT SECTIONS 10(b), RULES 10b-5

During the period from on or about _____ 19 __ to on or about _____ 19 __ registrant wilfully violated and _____ wilfully aided and abettted violations of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, in that said persons, by use of the means and instrumentalities of interstate commerce and the mails, in offering, selling, purchasing and effecting transactions in securities, namely common stock of _____, directly and indirectly, obtained money and property by means of untrue statements of material facts and omissions to state material facts necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading and engaged in transactions, acts, practices and a course of business which would

and did operate as a fraud and deceit upon purchasers and prospective purchasers of such securities. As part of the aforesaid conduct and activities, said persons, among other things, would and did -- (Pickard 8/68)

B. SPECIFIC MISREPRESENTATIONS AND OMISSIONS

1. LEAD-IN LANGUAGE FOR SPECIFIC CHARGES OF MISREPRESENTATIONS AND OMISSIONS

Make false and misleading statements of material facts and omit to state material facts concerning, among other things --

2. RISK INVOLVED, MARKET, PRICE, VALUE, GROWTH, DIVIDEND AND OTHER PROSPECTS AND CHARACTERISTICS RELATING TO THE SECURITY OFFERED.

a. the speculative nature of XYZ stock;

b. the unusually high risk involved in an investment in XYZ stock;

c. the safety of an investment in XYZ stock;

d. the assurance of a present and future market for XYZ stock;

e. the existence of a bona fide independent market for XYZ stock;

f. the fair and reasonable market price of XYZ stock;

g. the book value of XYZ stock;

h. anticipated future dividends to be paid by XYZ;

i. the listing of XYZ on the American Stock Exchange;

j. a prospective rise in the price of XYZ common stock;

k. the soundness of an investment in XYZ common stock;

l. the participation of the respondent and others in the distribution of the common stock of XYZ when no registration statement had been filed or was in effect with respect to said securities under the Securities Act;

m. respondent's right to acquire XYZ shares at a price substantially below the market;

n. the arrangement by XYZ to issue an additional 1,000,000 shares of common stock;

o. the safety, soundness and investment quality of the stock of _ _ _ _ _ _ _ _ in the light of the customers' individual financial situations and investment needs and objectives;

p. the payment of dividends and returns of 6% by _ _ _ _ _ _ _ to its stockholders, and the source thereof;

q. the prospects of a stock dividend;

r. the demand for stock of _ _ _ _ _ _ _ _ and the availability of shares remaining to be sold at $1.00 per share;

s. a proposed new offering of _ _ _ _ _ _ _ _ stock at $2.00 per share and its effect upon the value of such stock sold at $1.00 per share;

t. prospective increases in the price of stock of _ _ _ _ _ _ _ ;

u. the arbitrary nature of the price at which stock of _ _ _ _ _ _ was offered and lack of an established market for such stock;

v. the willingness and ability of _ _ _ _ _ _ _ _ to repurchase its stock upon request and the prospects for resale of such stock;

w. the speculative nature of an investment in stock of _ _ _ _ _ _ _ ; and the dilution to be suffered by paying $1.00 per share therefore;

and statements and representations of similar object and purport.

3. AVAILABLE SUPPLY OF THE SECURITY, THE SOURCE, SELECTION OF OFFEREES, USE OF PROCEEDS, SEC APPROVAL ETC.

a. the amount of XYZ stock available for sale;

b. the number of shares of XYZ stock being offered to the public;

c. the source of the XYZ stock being offered and sold;

d. the nature and composition of a limited group of people to whom XYZ stock would be exclusively offered;

e. the application and use of proceeds of the offering;

f. the misapplication and diversion of funds realized from the sale of XYZ stock;

g. the purported approval of the XYZ offering by the United States Securities and Exchange Commission;

4. FINANCIAL CONDITION, OPERATIONS AND PROSPECTS OF ISSUER.

a. the profitable operations of XYZ;

b. the nature of the business operations in which XYZ would engage;

c. the competitive conditions of the industry in which XYZ intended to operate;

d. the financial condition of XYZ;

e. pending proceedings against XYZ in connection with a bankruptcy petition filed by creditors of XYZ;

f. the proposed acquisition of _ _ _ _ _ _ _ _ by XYZ and _ _ _ _ _ assets, contracts and prospective operations;

g. the business, operations and extent of growth and progress of _ _ _ _ _ _ _ _ ;

h. XYZ's future prospects for growth and success;

i. the past and future earnings of XYZ;

j. substantial prior operating losses incurred by XYZ;

k. the income expenses and related figures as stated in XYZ's profit and loss statement dated _ _ _ _ _ _ _ _ 19 _ _ purportedly covering XYZ's operations from _ _ _ _ _ _ _ _ 19 _ _ to _ _ _ _ _ _ _ _ 19 _ _ ;

l. the assets, liabilities, capital and surplus items as stated in XYZ's balance sheet dated _ _ _ _ _ _ _ _ 19 _ _ ;

m. the value of the assets of XYZ;

n. various sources of financing available to XYZ;

o. the wide public acceptance of the products of XYZ;

p. the existence of a present and future market for XYZ products;

q. the backlog for orders of XYZ products;

r. a contract between XYZ and Peter Smith dated _ _ _ _ _ _ _ _ 19 _ _ wherein XYZ is purportedly bound to issue 1,000 shares of common stock to Smith in consideration for certain prior services rendered to XYZ by Smith;

s. the terms of various contracts requiring XYZ to repurchase certain of its shares for the benefit of creditors;

t. the assignment to creditors of title to certain properties and equipment owned by XYZ;

u. the identity of the assignee of an exclusive license to manufacture certain XYZ products;

v. **options purportedly held by XYZ on certain real estate properties;**

w. the possession by XYZ of certain patent rights;

x. the production of TUV, a wholly-owned subsidiary of XYZ

y. contracts purportedly held by TUV;

z. the merger of XYZ with TUV;

aa. comparisons of the growth potential of XYZ with established, highly successful companies that possessed a much greater capitalization than XYZ;

5. MANAGEMENT AND CONTROL PERSONS OF ISSUER.

a. the identity of the management of XYZ;

b. the management experience of the officers and directors of XYZ;

c. the amount of XYZ stock beneficially owned directly and indirectly by the officers and directors of XYZ;

d. the interrelationship and common control of registrant,XYZ, TUV and the officers and directors thereof;

6. PROMISES TO INVESTOR OF PROTECTION AGAINST LOSS

a. guarantees against loss by registrant to the purchasers of XYZ stock and assurances that registrant would repurchase the XYZ stock at a profit at any time in the future;

b. the return to investors of a portion of the purchase price paid for XYZ stock;

7. STATUS AND ACTIVITIES OF BROKER-DEALER, RELATED PERSONS, CORPORATE INSIDERS ETC. REGARDING SUCH MATTERS AS BROKER-DEALER LICENSE, MANIPULATION, INSIDER PURCHASES FOR LITTLE OR NO CONSIDERATION, NOMINEE ACCOUNTS, SALE BY "CONTROL PERSONS," CONFLICT OF INTEREST, MARK-UPS, STOCK EXCHANGE STATUS AND EXISTENCE OF RESEARCH SERVICE.

a. the existence of a license to sell securities in New York purportedly granted by the State of New York to registrant;

b. the participation by registrant, Doe, Rae, XYZ, TUV and others, in a scheme to manipulate the market price of XYZ stock;

c. purchases of XYZ stock by registrant, Doe, Rae and other insiders;

d. the issuance of XYZ stock to registrant, Doe and Rae for little or no consideration;

e. the prices paid for XYZ stock by registrant, Doe and Rae;

f. the placing of a substantial portion of the XYZ stock offering into nominee accounts controlled by registrant, Doe and Rae;

g. sales of XYZ stock by registrants, Doe, Rae and other "control" persons;

h. the nature and extent of interests of registrant, Doe and Rae in JKL Corporation which conflicted with the interests of XYZ;

i. the size of registrant's mark-ups over contemporaneous costs in selling XYZ stock;

j. the acquisition of a seat on the American Stock Exchange by registrant;

k. the existence of a research department in registrant's office capable of rendering research services for registrant's customers.

C. OTHER FRAUDULENT CONDUCT BY BROKER-DEALERS, REGISTERED REPRESENTATIVES, ETC.

1. CONDUCT BY REGISTERED REPRESENTATIVES IN ATTEMPT TO CONCEAL DISTRIBUTION OF UNREGISTERED STOCK.

Embark on a course of conduct with a view to distributing the unregistered shares of _ _ _ _ _ _ _ on behalf of himself and others and in connection therewith took steps to conceal said activities and to avoid detection by:

a. effecting sales of _ _ _ _ _ _ _ in an account established on behalf of himself with a broker-dealer other than his employer;

b. executing sales for controlling persons and others who obtained their shares from controlling persons of _ _ _ _ _ _ _ without disclosure of said facts to his employer;

c. facilitating the execution of sales of _ _ _ _ _ _ _ through use of an opinion letter purporting to express a legal opinion that the shares of _ _ _ _ _ _ _ being sold were not subject to the registration requirements of the Securities Act without revealing that the person signing the letter was himself a controlling person and was participating in the distribution of _ _ _ _ _ _ _ shares;

2. FRAUDULENT RECOMMENDATION OF STOCK

Recommend the purchase of, offer and sell to customers the speculative and unseasoned securities of _ _ _ _ _ _ _ _ without first having made reasonable and diligent inquiry and in disregard of information as to the past and present financial condition and business operations of _ _ _ _ _ _ _ _ .

3. MANIPULATION OF MARKET OF PARTICULAR STOCK

(a) During the period from approximately _____ to _____ permitted _____ A _____ an employee of _____ B _____ and others to maintain, dominate, control and minipulate the market for XYZ stock and to effect transactions intended to artifically influence the market price for XYZ shares and create a false and misleading appearance of an active market for such shares. (Jay Saluc 2/12/68)

(b) publish bids for and purchase such stock for its own account at successively higher prices for the purpose of creating an apparent market in and raising the price of said stock while inducing other broker-dealers to enter both bid and ask quotations for said stock in the National Daily Quotation Service.

(c) sell securities for its own account while it held and was in receipt of sell orders for its customers.

(d) maintain, dominate, control and manipulate the market for securities of Medallion. (Hancock Securities Corp. 1/16/69)

4. DISCOUNT ARRANGEMENT WITH CONTROL PERSON

Enter into an arrangement with A, principal and controlling person of B Co., under which A would make available to N (one of the respondents) special inducements in the form of offering to an account which N controlled and in which N had a beneficial interest and certain customers securities of B Co. at prices which were substantially below the prices at which registrant, N and other broker-dealers were effecting transactions in such securities; (Pickard & Co. 8/68)

5. USING REGISTRANT TO LEND PRESTIGE TO A MARKET

Lend the prestige and name of registrant in connection with the trading market for the securities of _ _ _ _ _ _ _ _ by arranging for registrant to place quotations for such securities in the National Daily Quotation sheets and in connection therewith quote prices for the common stock of _ _ _ _ _ _ _ _ at prices ranging from about $3.00 to approximately $9.00 without having made reasonable and diligent inquiry as to the past and present financial condition of _ _ _ _ _ _ _ _ , its products, offices, officers and principals; (Pickard - 8/68)

6. TRADED THROUGH OWN ACCOUNT WHICH WAS MISREPRESENTED AS A CUSTOMERS ACCOUNT

Purchase, offer to purchase, sell, offer to sell and effect transactions in the common stock of _ _ _ _ _ _ _ by and through an account allegedly of a customer of the firm when in fact such offers and transactions were being made by _ _ _ _ _ _ _ _ and said account was being used as a trading account for _ _ _ _ _ _ _ _ and registrant and in connection therewith fail to disclose, by confirmations or otherwise, that registrant and _ _ _ _ _ _ _ _ had a beneficial interest in and control of said account; (Pickard - 8/68)

7. ACCEPTED ORDERS WHEN INCAPABLE OF PROMPTLY CONSUMMATING TRANSACTION

Accept orders for the purchase and sale of securities and effect transactions in securities on behalf of customers at a time when registrant was incapable of promptly consummating said transactions and at a time when:

(a) registrant's books and records were not current, contained numerous errors and could not be relied upon to accurately and promptly reflect the amount of securities or cash held for the account of customers;

(b) registrant did not have the facilities and personnel necessary in order to promptly consummate customers' securities transactions and to make prompt delivery of securities and cash to such customers;

(c) registrant was not in compliance with the financial requirements imposed by the NYSE. (Pickard & Co. - 8/68)

8. INDUCED PERSONS TO SUBORDINATE SECURITIES AND CASH TO REGISTRANTS GENERAL CREDITORS

Induce persons to subordinate their securities and cash to the general creditors of registrant by means of false and misleading statements of material facts and omissions to state material facts concerning, among other things:

(a) the financial condition of registrant;

(b) the extensive withdrawal of capital funds from registrant by certain of its officers and directors; (Pickard & Co. 8/68)

9. Removed

10. FAILURE TO EXERCISE DUE DILIGENCE TO INVESTIGATE ISSUER

Fail to exercise due diligence, reasonable under all the circumstances, in investigating the adequacy and accuracy of the statements made in the prospectuses [or offering circulars] of XYZ Corporation

and TUV Corporation, while engaged in the underwriting, distribution, and sale of the common stock of those issuers' particularly, with respect to: [any statement in the prospectus or offering circular which reasonable inquiry would have disclosed was inaccurate or inadequate.]

(b) Without regard to its obligations as an underwriter (or broker-dealer), engage in the offer, sale and distribution of unseasoned, speculative securities of XYZ and TUV without making a reasonable and diligent inquiry as to the true nature and worth of such securities, which inquiry would have revealed that: [any other adverse facts that reasonable inquiry would have disclosed.]

(c) Without regard to its obligations as an underwriter (or broker-dealer), engage in the offer, sale and distribution of unseasoned, speculative securities of XYZZ and TUV without making a reasonable and diligent inquiry as to the true nature and worth of such securities, although on notice of facts and circumstances which made such inquiry essential and which inquiry, if made, would have revealed: (any adverse facts that reasonable inquiry would have disclosed).

11. TRUST AND CONFIDENCE

(a) induce customers to repose trust and confidence in them causing such customers to believe that they would deal fairly with them in connection with all purchases and sales of securities;

(b) fail to disclose to such customers the nature and extent of respondents' adverse interest in such transactions;

(c) induce the customers to purchase the unseasoned and speculative securities, including those of ABC, Inc., FF, Inc., HC, Inc., HMSC (HM), and WNC in disregard of or without inquiry as to the suitability of such securities to the individual customers' financial needs, circumstances or objectives;

(d) make untrue, deceptive, and misleading statements of material facts and omit to state material facts to purchasers and prospective purchasers of HM stock concerning, among other things:

(Richard N. Cea et al 9/14/66)

12. INDUCE UNSOPHISTICATED INVESTOR TO SWITCH FROM SEASONED TO SPECULATIVE SECURITIES AND ACTIONS CONNECTED THEREWITH--SUITABILITY

(a) Induce and cause Mrs. Mary S., then a widow close to ninety years of age and without close relatives or kin, to repose her full trust, confidence, and reliance upon the integrity, knowledge, judgment and business acumen of respondent;

(continued on next page)

(b) Induce and cause Mrs. S. to sell seasoned securities, consisting of listed and unlisted common stocks and bonds, in an amount of approximately $216,000;

(c) Induce and cause Mrs. S. to use part of such proceeds of sale to purchase respondent's personal unsecured promissory notes totaling a like amount;

(d) Induce and cause Mrs. S. to turn over to respondent, ostensibly in the form of unsecured loans, certain of the proceeds of sale of Mrs. S's securities;

(e) Make false and misleading statements of material facts and omit to state material facts necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading with regard to the said promissory notes, and the purchase and sale of listed and unlisted common stock in Mrs. S's account, concerning, among other things:

(1) the financial ability of respondent to repay these notes and unsecured loans;

(2) the financial ability and intention of respondent to pay interest on these notes;

(3) the relative merits of investments in these notes as contrasted with other securities;

(4) the use to which the proceeds from the sales of these notes and common stock were to be put;

(5) the safety of investing in these notes;

(6) the activities described in paragraphs (1) through (4) above.

(Gregory - 6/68)

13. CONCEALMENT OF ABOVE ACTIVITIES

Conceal the activities described in paragraphs (a) through (e) above from his employer on whose behalf respondent serviced the account of Mrs. S.

14. INVESTMENT CONTRACT - MORTGAGE NOTES

In the course of operations of the registrant, commence the offer to sell, sale and delivery after sale of investment contracts consisting of first and second lien mortgage notes acquired from a Company coupled with agreements wherein purchasers were provided with the servicing (including foreclosure when necessary) on said notes and further providing a guarantee against loss and a guarantee of 10% return thereon;

offer for sale and sell the aforesaid investment contracts and notes to customers of registrant but conceal the nature and amount of these transactions by failing to reflect these and other related transactions on the books and records of the Corporation, which corporation was operated by respondents for the purpose of concealing said transactions; (Abbot-Somers)

15. INCONSISTENT RECOMMENDATIONS (SELLING WHILE RECOMMENDING THAT CUSTOMERS PURCHASE ETC.

(1) arrange and participate in a plan with certain persons to acquire large stock interests in and assume control of the affairs of Allied and on behalf of such persons and on their own behalf purchase and offer to purchase the common stock of A; and, thereafter, engage in a distribution of the common stock of A and induce customers of registrant to purchase the shares of A and in connection therewith fail to disclose to the customers of registrant to purchase the shares of A and in connection therewith fail to disclose to the customers of registrant that A and registrant were under common control and that registrant had an interest and was participating in a secondary distribution of A stock;

(2) execute sell orders on behalf of themselves, the persons described in subparagraph (1) above and other closely associated persons at or about the time they were recommending the purchase of such shares to the customers of registrant and in connection therewith, fail to disclose such activities to said customers;

(3) effect a series of transactions in Allied stock, to create actual and apparent trading and artificially raise and maintain the price, for the purpose of inducing others to purchase said securities;

(4) represent to customers that transactions in the shares of Allied were being effected at "the market price" when in fact sales were being made at arbitrarily established prices, and no market existed other than the one created, dominated and controlled by registrant;

(5) induce customers to purchase and as principals offer and sell to its customers such securities at prices which were excessive and unreasonable;

(R. J. Henderson & Co., Inc. 11/17/66)

16. INTERPOSITIONING

A. Charge against Registrant & its aiders & abettors who is receiving order from customer.

During the period from on or about _____ to on or about _____ willfully violated and willfully aided and abetted violations of Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder, in that said persons in connection with the execution of customers' agency orders for the purchase and sale of securities in the over-the-counter market, directly and indirectly, employed devices, schemes and artifices to defraud, made untrue statements of material facts and omitted to state material facts necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, and engaged in acts, practices and courses of business which would and did operate as a fraud and deceit upon customers. As part of aforesaid conduct and activities and contrary to _____obligation to treat its customers fairly and to act in their best interest, _____, would and did, among other things:

1. **cause its customers to incur unnecessary costs and charges by interposing _ _ _between _ _ _ _ and other broker-dealers in the execution of securities transactions in the over-the-counter market;**

2. **fail to seek and obtain for its customers best execution in the purchase and sale of securities in the over-the-counter market;**

3. **carry out the activities set forth in subparagraphs (1) and (2) above for the purpose of securing for reciprocal business and additional compensation; and**

4. **fail to disclose to its customers by confirmation or otherwise the activities described in paragraphs (1) through (3) hereof.**

(Thomson & McKinnon - 3/14/68)

B. Charge against broker-dealer who is being interpositioned (See D of Flor Bullard)

During the period from on or about _____ to on or about A, B _____ and _____ willfully violated and willfully aided and abetted violations of Section 17(a) of the Securities Act of 1933 and Sections 10(b) and thereunder, in that said persons, in connection with the execution of purchases and sales of securities in the over-the-counter market, directly and indirectly, employed devices, schemes and artifices to defraud, made untrue statements of facts and omitted to state material facts necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading and engaged in acts, practices and courses of business which would and did operate as a fraud and deceit upon Filor's customers. As part of the aforesaid conduct and activities, said persons would and did, among other things:

(1) aid, abet and counsel Filor in carrying out and effecting the activities and transactions described in paragraphs and above;

(2) induce and cause Filor in the execution of transactions in the over-the-counter market to interpose A between Filor and other broker-dealers and thereby cause Filor's customers to incur unnecessary costs and charges;

(3) obtain for A the business described in subparagraph (2) above through an arrangement under which B and C acting for themselves and on behalf of A referred listed business to Filor for the purpose of influencing and rewarding Filor in placing Filor's customers' orders with A

(4) cause Filor to effect purchases and sales of over-the-counter securities through A and in connection therewith to incur costs and charges which were passed on to Filor's customers notwithstanding that the services performed by A were unnecessary in order to obtain appropriate execution of customers' orders.

(Filor, Bullard & Smyth 6/13/68)

17. BOILER ROOM TECHNIQUES

Engage in the distribution and sale of the speculative, unseasoned securities of XYZ and TUV to investors with whom they were unacquainted by virtue of a "boiler-room" sales campaign; and as a part of the aforesaid conduct:

(1) employed an intensive long distance telephone and direct mail solicitation campaign utilizing flamboyant and misleading lotters, advertisements, brochures, newspaper reprints and other sales literature;

(2) made material misrepresentations concerning the nature and scope of registrant's business, staff, research facilities, and reputation in the securities industry;

(3) permitted, encouraged and arranged for registrant's salesmen to "load" and "reload" investors with securities of XYZ and TUV, and to "switch" customers out of seasoned, dividend-paying securities in order to provide them with funds to purchase XYZ and TUV securities;

(4) Permit, encourage and arrange for the employment as salesmen for registrant of individuals who had no prior experience, training or qualifications as securities salesmen and permit, encourage and arrange for registrant's salesmen to offer and sell securities to customers without suitable training or indoctrination in the standards of conduct required of those engaged in the securities business; and (Fabrikant 7/17/64)

(5) permitted, encouraged and arranged for registrant's salesmen to conduct with virtually no supervision selling from their homes at hours of their own choosing through high pressure techniques utilizing leads and referrals provided by registrant.

18. FAILURE TO COMPLETE TRANSACTIONS

Manage fraudulent course of business in connection with which registrant offered and sold securities to and for inexperienced and unsophisticated customers, but despite repeated customer demands, failed and refused to:

(1) deliver promptly to customers securities fully paid for by such customers;

(2) deliver promptly to customers proceeds from sales of securities in the accounts of such customers; and

(3) execute promptly sell orders placed by such customers.

19. FAILURE TO COMPLETE TRANSACTIONS, SWITCHING, CONVERSION OF INVESTOR FUNDS

During the period from about September 1965 to the date hereof, registrant wilfully violated Sections 10(b) of the Exchange Act and Rules 10b-5 thereunder in that he effected transactions in and induced the purchase and sale of securities and in connection therewith engaged in acts, practices, and a course of business which would and did operate as a fraud and deceit upon certain persons, made untrue statements of material facts and omitted to state material facts necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading and directly and indirectly employed devices, schemes and artifices to defraud and obtain money and property. As a part of the aforesaid conduct and activities, registrant, among other things, would and did:

(1) Fail and refuse, despite repeated customer demands therefor to complete purchases and deliveries of securities fully paid for and belonging to such customers.

(2) Convert to his personal use monies paid to him by customers for the purchase of securities.

(3) Induce the sale of securities held by customers, who relied upon registrant for investment advice, by enticing such customers to reinvest the proceeds therefrom in different securities and then failed to timely purchase and deliver such new securities for the customers.

(4) Send false confirmations of purchases and sales of certain securities to customers.

(5) Make false and misleading statements of material facts and omit to state material facts concerning, among other things:

(a) the activities described in paragraphs (1) through (5) above;

(b) the financial condition of registrant;

(c) the use of funds and securities received from investors;

(d) the availability for purchase of stock ordered and paid for by customers;

(e) the delays in the completion of transactions for customers;

(f) the dates on which investments for customers were actually made;

and statements and representations of similar object and purport.

(Polycarpo 8/68)

19(a) PRICING PRACTICES, UNREASONABLE MARK-UPS, SPREADS AND COMMISSION, UNDISCLOSED SHORT SALES (Rule 10b-5)

Charge prices not reasonable related to the prevailing market price or to registrant's contemporaneous cost; and in connection therewith:

(1) induced excessive trading;

(2) charged unreasonable commissions and mark-ups;

(3) unilaterally fixed the prices at which XYZ stock was purchased and sold, and regularly raised arbitrarily the price of XYZ stock to successively higher prices without disclosing such facts to registrant's customers;

(4) permitted and arranged to be published and circulated bid (and asked) quotations for XYZ stock without disclosing that such quotations were not bona fide; and

19(b)

A. During the period from about August 1968 to October 1968, registrant and Hagen wilfully violated and wilfully aided and abetted violations of Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, in that the respondents in connection with the offer, sale and purchase of various securities, namely, among others the securities of United Founders Life Insurance Co., Community National Life Insurance Co., Stemen Laboratories, Inc., Amarand, Inc., and Texo Oil Corporation, directly and indirectly, employed devices, schemes and artifices to defraud, obtained money and property by means of untrue statements of material facts and ommissions to state material facts necessary in order to make the statements made in the light of the circumstances under which they were made, not misleading and engaged in transactions, acts, practices, and a course of business which would and operate as a fraud and deceit upon customers. As a part of the aforesaid conduct and activities, respondents, singly and in concert, among other things, would and did:

(1) Induce customers to purchase, and, as principals, offer to sell to customers, securities at prices which were excessive and unreasonable;

(2) Induce customers to sell, and, as principal, offer to buy from customers, securities at prices which were unreasonable;

(3) While recommending certain securities as suitable for purchase and in effecting transactions therein with customers, respondents failed to disclose that they did not own or possess the securities so recommended and sold and that it was their design to profit from such transactions by being able to cover said short sales through subsequent purchases at prices which were materially less than the price at which such securities had been recommended and sold to said customers;

(4) Induce customers to repose trust and confidence in respondents, thereby causing said customers to believe respondents would deal fairly with said customers in effecting transactions with and on behalf of said customers and, in connection therewith, fail to disclose to said customers the nature and extent of respondents' adverse interest therein;

(5) In connection with the offer and sale, sale and purchase of various securities make untrue, deceptive and misleading statements of material facts, and omit to state material facts, concerning the matters alleged in sub-paragraphs (1) through (4) above. (Hagen Investments 3/7/69)

20. Tender Offer Case

During the period from approximately January 1966 to approximately March 1966, Liederman and Kaplan singly and in concert, wilfully violated and wilfully aided and abetted violations of Section 10(b) of the Securities Exchange Act of 1934 (Exchange Act) and Rule 10b-5 thereunder in that, in connection with the purchases and sales of certain securities, namely, the common stock of Heritage, they employed devices, schemes and artifices to defraud, made untrue statements of material facts and omitted to state material facts necessary to make the statement made, in the light of the circumstances under which they were made, not misleading, and engaged in acts, practices and a course of business which would and did operate as a fraud and deceit upon sellers and prospective sellers and purchasers and prospective purchasers of such securities. As a part of the aforesaid conduct and activities, among other things:

(1) Liederman and certain of his associates (The Liederman Group) contracted on January 31, 1966, to acquire more than 50% of the outstanding shares of Heritage from the officers and directors of the Company at $3.98 per share. Under the terms of that contract the Liederman Group agreed to offer to purchase the Heritage stock held by all other shareholders by a tender offer to purchase at the same price offered to the officers and directors;

(2) Liederman and the Liederman Group would and did, on February 10, 1966 and continuing through about March 2, 1966, make a public tender offer to Heritage shareholders to purchase all of the outstanding shares of Heritage in accordance with the terms of the published tender offer;

(3) Liederman and the Liederman Group would and did, during the period from about February 10, 1966 to about March 16, 1966, purchase the Heritage shares tendered in the above-described tender offer at the tender offer price of $3.98 a share;

(4) Liederman and the Liederman Group would and did, during the period from about February 10, 1966 to about March 16, 1966, publicly distribute and sell the Heritage shares tendered by Heritage shareholders in the above-described tender offer at prices ranging from about $6.81 to about $9.75 per share;

(5) Liederman would and did, during the period from about February 10, 1966 to about March 16, 1966, while purchasing and then selling the Heritage shares tendered by Heritage shareholders in the above described tender offer, induce certain of his friends and associates to purchase Heritage shares and entered purchase orders on behalf of certain friends for these tendered shares;

(6) Liederman and the Liederman Group would and did during the period from about February 10, 1966 to about March 16, 1966, omit to disclose to the tendering shareholders and other shareholders of Heritage that the shares being accepted for tender were being resold by the Liederman Group to and through registrant with the aid of Kaplan and also were being sold to others;

(7) Liederman and Kaplan while engaged in the public distribution and sale of Heritage shares as aforesaid, would and did omit to disclose to purchasers and prospective purchasers of such shares that the Heritage shares being distributed and sold were received pursuant to the pending tender offer and were being purchased pursuant to that tender offer;

(8) Liederman and Kaplan would and did during the period aforesaid, offer to sell, sell and deliver after sale the tendered securities of Heritage when no registration statement under the Securities Act had been filed or was in effect with respect to such securities;

(9) Liederman and the Liederman group wilfully violated and wilfully aided and abetted violations of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-6 thereunder (17 CFR 240.10b-6) in that while participating in a distribution of the common stock of Heritage they bid for and purchased such securities for accounts in which they had beneficial interest and induced other persons to purchase such securities prior to completing said distribution;

(10) Liederman and Kaplan would and did make false and misleading statements of material facts and omissions to state material facts necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading concerning, among other things:

a. The activities described in sub-paragraphs (1) through (9) above;

b. The current market price for the Heritage shares;

c. The prices at which the tendered Heritage shares were concurrently being sold;

d. The use of the proceeds from the sale of the tendered Heritage shares.

In carrying out the activities and course of business described in Paragraph B of Section II hereof and during the period of time described herein, registrant, Liederman and Kaplan, singly and in concert, wilfully

violated and wilfully aided and abetted violations of Sections 5(a) and 5(c) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-6 thereunder in the manner and means more fully described in the following referenced sub-paragraphs of paragraph B:

Sections 5(a) and 5(c) of the Securities Act	Subparagraphs 4 and 8
Section 10(b) of the Exchange Act and Rule 10b-6 thereunder	Subparagraphs 2, 3, 4 and 9

21. **SWITCHING - MUTUAL FUNDS**

(a) With knowledge of the total amounts available for investment, solicit and induce customers to make multiple purchases of mutual fund shares, the amounts of the individual purchases solicited falling below the break point where a reduced sales load would be charged.

(b) Solicit and induce customers to liquidate shares of one mutual fund and purchase shares of another, when such transactions were adverse to the interests of the customers.

(c) Make untrue, deceptive, and misleading statements of material facts and omit to state material facts concerning investments in mutual fund shares including:

(1) The amount of sales load paid for the shares of mutual funds;

(2) The use and effect of a statement of intention in the purchase of mutual fund shares;

(3) The use of a withdrawal plan to increase cash disbursements to investors;

(4) The future prospects of investments in certain mutual fund shares;

(d) Cause customers to incur excessive and unnecessary commissions, costs, charges, and expenses by engaging in the activities set forth in this paragraph.

(Paine, Weber - 8/68)

22. CONFIRMATION RULE (see also #28)

During the period mentioned in paragraph A hereof, registrant wilfully violated and respondents wilfully aided and abetted such violations of Section 15(c)(1) of the Exchange Act and Rule 15c1-4 thereunder, in that registrant effected transactions in the _____ _____ Corporation (hereinafter referred to as _____) securities, with and for the accounts of customers without, at or before the completion of each such transaction, giving or sending to every such customer a written confirmation correctly disclosing the capacity in which registrant acted and with respect to transactions effected as agent the actual amount of commission or other remuneration received or to be received in connection with the transaction. (Assoc Securities 3/68)

23. FAILURE TO DISCLOSE COMMISSIONS IN AGENCY TRANSACTION

During the period from on or about _____ to on or _____ _____, willfully aided and abetted by _____ willfully violated Section 15(c)(1) of the Securities Exchange Act of 1934 and Rule 15c1-4 thereunder, in that _____, in connection with the execution of customers' orders for the purchase and sale of securities in the over-the-counter market on an agency basis, failed to give written notification to its customers at or before completion of each such transaction of the source and amount of all commissions and other remuneration received or to be received by _ _ _ in connection with the transaction; and, as a result of and in further respect to such activities, misrepresented the actual prices at which the said transactions were being effected. (Flor Bullard 6/68)

24. CHURNING (EFFECTING TRANSACTIONS EXCESSIVE IN SIZE AND FREQUENCY)

During the period from on or about _____ to on or about _____, registrant wilfully violated, and _____ _____wilfully aided and abetted violations of Section 15(c)(1) of the Exchange Act and Rule 15c1-7 thereunder in that registrant effected transactions of purchase and sale of securities (other than commercial paper, bankers' acceptances, or commercial bills), with or for customers' accounts in respect to which _____ were vested with discretionary power, which transactions were excessive in size and frequency in view of the financial resources and character of such accounts and which were otherwise in violation of said provision. (Pickard 8/68)

25. HYPOTHECATION

During the period _____ through _____ respondent _____ wilfully aided and abetted violations by _____ _____ of Section 15(c)(2) of the Exchange Act and Rule 15c2-1 thereunder in that respondent _____ caused _____ directly and indirectly to hypothecate securities carried for the account of customers and in connection therewith:

(a) in contravention of Rule 15c2-1 permitted such securities to be commingled with securities carried for the account of persons other than a bona fide customer of _____ under a lien for a loan made to _____;