SIGNIFICANT CURRENT ISSUES
CONFRONTING THE SECURITIES AND EXCHANGE COMMISSION

August 18, 1989

I. INTERNATIONALIZATION

The internationalization of the securities markets presents a wide range of challenges in many of the Commission's areas of responsibility. Nearly all of the Commission's offices and divisions are involved in projects relating to internationalization.

A. Capital Raising 1/

The Commission is seeking to remove impediments to capital raising, while being sure that those who choose to buy securities in this country are afforded the protections of our laws. The Commission has sought to accommodate foreign law and practice, while avoiding accommodations that unduly advantage foreign issuers over domestic ones. The Division of Corporation Finance has several ongoing projects in this area:

1. First, and most likely to lead to fundamental change in the long run, is the multijurisdictional disclosure system, to date proposed only for Canadian issuers, under which a qualifying company will be able to use a disclosure document prepared in accordance with its home requirements to conduct securities offerings and meet continuous reporting obligations in the United States.

2. Proposed Regulation S, which will clarify the transnational scope of the registration requirements of the Securities Act and contains non-exclusive safe harbors from those requirements.

3. Proposed Rule 144A, which would provide a safe harbor exemption from the Securities Act registration requirements for specified institutional resales of securities, and the related proposals by the AMEX and the NASD for the SITUS and PORTAL systems. See discussion below.

1/ See Sections II and XII of the briefing materials.

B. International Accounting and Auditing Issues 2/

Significant differences currently existing among countries in accounting, auditing, and independence standards serve as an impediment to multinational filings. SEC staff and securities regulators and members of the accounting profession throughout the world are engaged in efforts to revise international accounting and auditing standards in order to increase comparability and reduce costs to registrants. For example, the staff is working with the International Accounting Standards Committee (IASC), an international body with membership from 71 countries, to eliminate the number of accounting options permitted under some of the countries' standards. On January 1, 1989, IASC issued an exposure draft addressing accounting issues such as revenue recognition, business combinations, investments, retirement benefits, and foreign currency. The exposure draft has a comment period of nine months.

C. Globalization of the Trading Markets 3/

The Commission and its Division of Market Regulation have implemented and have under consideration a number of initiatives relating to the increasing globalization of securities trading.

1. Foreign Broker-Dealer Regulation. As U.S. investors expand their holdings of foreign securities, they often seek access to foreign broker-dealers that are not registered with the Commission as broker-dealers. To increase this access while maintaining investor safeguards and Commission enforcement authority, the Commission in June 1989 adopted Rule 15a-6, which exempts certain types of foreign broker-dealer contacts with U.S. investors. It also sought comment on the concept of relying on comparable foreign regulation and cooperation with foreign authorities in place of U.S. broker-dealer regulation for certain foreign broker-dealers dealing with U.S. investors.

2. Group of Thirty Recommendations. The Division is currently assisting private sector initiatives to implement the Group of Thirty recommendations for

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2/ See Sections II and XII of the briefing materials.

3/ See Section XII of the briefing materials.

improvements in national clearance and settlement systems, including shortening the period between the trade and settlement dates.

3. Private Placement Trading Systems. The Division is currently reviewing NASD and Amex proposed private placement trading systems designed to operate under proposed Rule 144A.

4. International Capital and Surveillance Coordination. The Division is currently working on a bilateral basis with the United Kingdom and on a multilateral basis with the European Economic Community and international organizations to foster coordinated minimum capital requirements and mutual surveillance sharing agreements.

D. International Enforcement Matters 4/

The Commission has sought to establish a balance between the desire to open U.S. markets to foreign investment and the need to maintain the integrity of the U.S. marketplace for the benefit of all investors. The Office of International Affairs in the Division of Enforcement ("Office") has been designated by the Chairman to coordinate Commission policies relating to internationalization of the U.S. securities markets. The Office acts as liaison with the Departments of Justice, State and Treasury for international matters, including law enforcement, and coordinates all incoming and outgoing Commission requests for international legal assistance.

1. Negotiation of Memoranda of Understanding. The Commission has entered into Memoranda of Understanding ("MOUs") to facilitate exchanges of information and cooperation with authorities in Switzerland, the United Kingdom, Japan, Canada and Brazil. The Office currently is negotiating MOUs with the securities authorities in Australia, France, and The Netherlands. The Office expects that these agreements will be ready for final Commission action within the next few months. The Office has initiated discussions with the securities authorities in Hong Kong, Italy, Mexico, Spain and Sweden which will continue during the coming year.

4/ See Section XII of the briefing materials.

2. Implementing Legislation for Memoranda of Understanding. In 1988 the Commission obtained legislation to permit the SEC to utilize subpoena authority to obtain information requested by foreign regulators. In September, the Commission will consider the first request that would require the utilization of this provision.

   In 1988 and 1989, the Commission also proposed amendments to the Exchange Act to provide: (a) an exemption from the Freedom of Information Act for confidential documents obtained from a foreign securities authority; (b) clarification of the Commission's authority to provide foreign and domestic regulators with access to its nonpublic files; and (c) authority to sanction foreign securities professionals who seek to register in the U.S. and who have been found to have violated foreign securities laws. Passage of proposals (a) and (b) is crucial to the Commission's ability to implement fully comprehensive agreements with the U.K. and France. This proposal is pending in both the House and Senate.

3. Participation in International Organizations. The Commission is a member of the International Organization of Securities Commissions which includes most of the world's securities regulators. The annual meeting of the IOSCO will be held in Venice from September 18-22, 1989. The Commission is slated to host the annual meeting in September 1991 in Washington, D.C.

   The Commission staff also participates in meetings relating to securities regulation at the European Community, the Organization for Economic Cooperation and Development, the Bank for International Settlements, INTERPOL, and the Wilton Park Group, an informal group of representatives from ten countries which meets annually to discuss securities enforcement issues.

4. Other Negotiations. The Office provides technical assistance to the Office of International Affairs of the Department of Justice relating to negotiation of Criminal Mutual Legal Assistance Treaties to ensure that these agreements adequately address securities enforcement issues. The Office also coordinates the Commission's efforts with respect to the negotiations of the Financial Services portion of

the General Agreement on Tariffs and Trade (GATT).

II. REGISTRATION AND DISCLOSURE ISSUES 5/

A. Institutional Resales

Proposed Rule 144A, as noted above, would provide a safe harbor exemption for resales of restricted securities to "qualified institutional buyers." The rule should increase liquidity and efficiency in the private resale market. The AMEX and the NASD have proposed closed trading systems for such trading.

B. Evolving Disclosure Issues

The Division of Corporation Finance is continually faced with novel questions concerning the application of disclosure and accounting requirements to new securities, and evolving financing techniques, such as remarketed adjustable rate preferred securities and investments in high yield securities. The Division reviews existing disclosure requirements and other rules to assure that they keep pace with evolving practice. Examples include recently adopted Rule 430A, which permits registration statements to become effective without pricing information, and a new project to review shelf registration procedures.

Significant disclosure issues also are raised by developments outside the securities industry. Examples include bank holding company accounting and disclosure issues resulting from LDC debt restructurings, and savings and loan holding company disclosure concerning financial assistance from regulatory authorities and the impact of the savings and loan reform legislation.

C. Amendments to the Trust Indenture Act

Pending legislation proposed by the Commission would modernize the Trust Indenture Act of 1939, make its commands self-executing (which would conserve staff time for more substantive tasks) and provide the Commission with general exemptive authority.

D. EDGAR

The Commission is preparing for the transition to mandatory electronic filing. Extensive rulewriting efforts are

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5/ See Section II of the briefing materials.

underway. The transition period will continue for 36 to 48 months and will involve review inefficiencies as the staff is trained and adjusts to the electronic filing process. There are also budgetary and technological issues related to the EDGAR project.

E. Accounting Issues 6/

1. Treadway Commission Recommendations. The National Commission on Fraudulent Financial Reporting (usually referred to by the name of its chairman, former SEC Commissioner James Treadway) was formed and funded by five private accounting organizations. The Treadway Commission studied issues related to the prevention and detection of fraud in the context of financial reporting, and issued its final report in October 1987. The report contains recommendations for public companies, independent public accountants, the Congress, the SEC, and others to reduce the incidence of fraudulent financial reporting. Recommendations directly addressed to the SEC include: all public companies should be required by SEC rule to establish audit committees composed solely of independent directors; all public companies should be required by SEC rule to include in their annual reports to shareholders a report acknowledging management's responsibilities for the financial statements and internal controls related to financial reporting, with an assessment of the effectiveness of those internal controls; the SEC should require independent public accountants to review registrants' quarterly financial data before it is released to the public; and the SEC should require all auditors of public companies to be members of a professional organization that has peer review and should take enforcement action when a public accounting firm fails to correct deficiencies noted in a peer review. These issues are discussed in Chairman Ruder's May 2, 1988 testimony.

2. Significant Accounting Standard-Setting Issues. The Financial Accounting Standards Board (FASB), a private sector standard-setting board subject to Commission oversight, currently is considering several controversial topics. These include:

6/ See Section III of the briefing materials.

a. Postemployment Benefits Other Than Pensions. This project is commonly referred to as OPEBs, for "other postemployment benefits." The FASB has issued an exposure draft that tentatively concludes that post retirement health care benefits represent a form of deferred compensation and that an obligation to pay for these benefits should be recognized on registrants' balance sheets as services are rendered. Research has indicated that the cost of these benefits is significant for some companies.

b. Income Taxes. The FASB has issued a statement that changes the method of accounting for income taxes. The new statement adopts a liability approach resulting in, among other things, the recognition in current earnings of the impact of changes in corporate income tax rates. The FASB, however, has deferred the effective date of this statement in response to concerns about the complexity of its implementation, and is continuing to study the new standard.

c. Financial Instruments. The FASB is continuing work on a project recommended by the Commission to address financial statement and off-balance sheet issues related to the recent creation of new and varied financial instruments. The FASB recently issued a revised exposure draft in this area.

d. Consolidations. In 1987, the FASB issued a statement to require companies, with limited exceptions, to consolidate all majority owned subsidiaries. This project also includes several groups of issues concerning: the concept of a "reporting entity" and related consolidation policy and procedures; accounting for investments in entities that do not qualify for consolidation; and recognition of a new basis of accounting for assets and liabilities in the separate financial statements of an entity.

III. TENDER OFFERS AND OTHER ISSUES RELATING TO CORPORATE CONTROL 7/

A. Tender Offers

In this area as well, the Commission is faced with continually evolving practices and techniques. A number of Division of Corporation Finance projects involve proposed changes in this area, including (a) proposed changes to Regulation 13D/G to reduce the reporting obligations of persons who do not have a control intent and highlight filings by persons who may have a control intent; (b) changes to require disclosure concerning equity participants in change of control transactions; (c) revisions to the Commission's going private rule to assure its application to transactions in which management will have a significant participation; and (d) application of valuation disclosure requirements to other extraordinary transactions.

B. Proxy Process

The growing concentration of equity ownership in institutional hands has focused attention on corporate governance issues, including the use of the proxy voting process by these shareholders as a means of gaining influence. Suggestions for legislative and regulatory action include mandating confidential voting, compulsory disclosure of institutional voting policies and results, and shareholder access to company proxy statements for the purpose of nominating board candidates.

C. Amendments to Regulations Governing Insider Beneficial Ownership Reports and Short-Swing Profit Liability

The Commission is reproposing for public comment extensive revisions of its rules and forms for the filing of ownership reports by corporate officers, directors, and principal shareholders, and the exemption of certain transactions by those persons from the short-swing profit recovery provisions of the Securities Exchange Act. The proposed rules are intended to provide greater clarity, enhance consistency with the statutory purposes, rescind unnecessary requirements, and streamline mandated procedures. In light of the continuing pattern of substantial delinquency (34.7% of transactions were reported late during the first five months of 1989), the Commission has also proposed to require issuer disclosure concerning delinquent filers.

7/ See Section IV of the briefing materials.

IV. TRADING MARKETS AND SECURITIES PROFESSIONALS 8/

The Commission and its Division of Market Regulation are engaged in a wide range of activities related to the regulation of the trading markets and the securities industry. These include issues that arise from the October 1987 Market Break as well as from the need to respond to changes in the nature of the markets and the participants in them.

A. Initiatives Responding to the October 1987 Market Break

1. Market Reform Legislation. Congress currently is considering a market reform bill (S. 648 and H.R. 1609, The Market Reform Act of 1989), which is based on a legislative package submitted by the Commission in June 1988 as a response to the October 1987 Market Break. The legislation would expand the authority of the Commission to adopt reporting rules for the purpose of monitoring the impact of large transactions upon the securities markets ("large trader reporting") and assessing the risks posed to registered broker-dealers from activities of unregulated affiliates ("financial holding company risk assessment"), provide the Commission with the authority to suspend trading for 24 hours during a market emergency, direct the Commission and the CFTC to facilitate the coordination of futures, commodity options, and securities clearance and settlement and give the Commission authority to preempt state commercial law concerning transfer and pledge of securities.

2. The President's Working Group (Treasury, Federal Reserve Board, CFTC, and SEC). The Division is participating at the staff level in the following Working Group projects: (1) intermarket financial monitoring and contingency planning, (2) improving intermarket clearance and settlement, (3) surveying automation of U.S. and foreign securities markets, and (4) extending intermarket circuit breakers beyond October 1989.

3. Clearance and Settlement. The Division staff is participating in the ABA Advisory Committee that is considering potential UCC or Bankruptcy Code impediments to efficient clearance and settlement. The Division is also reviewing

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8/ See Sections VI, VIII, IX and X of the briefing materials.

"cross-margining" proposals of the Options Clearing Corporation and Chicago Mercantile Exchange which would respond to the Brady Commission's recommendations to increase the coordination of futures and securities clearing systems and reduce financial payment system exposure during periods of market volatility.

4. Broker-Dealer Risk Assessment. The New York Regional Office is currently conducting a pilot examination program targeting this area. In addition, the 1990 Commission budget allocates five staff positions to create a capital markets unit in the Division of Market Regulation, which will develop, through examinations and studies, a thorough capability to monitor the credit and trading risks increasingly undertaken by U.S. broker-dealers and, as pertinent, their largely unregulated affiliates in the United States and abroad.

5. NYSE Market Basket Proposal. The Division is reviewing an NYSE proposal to establish systems and procedures for trading baskets of stocks. If approved, this may decrease market volatility associated with program trading.

6. Specialist Net Capital. The Commission has issued a release proposing for comment amendments to its uniform net capital rule that, among other things, will make the rule applicable to certain specialists that currently are exempt. Options market makers, designated as specialists for purposes of the rule, will continue to be exempt under certain conditions.

7. Minimum Net Capital. The Commission has issued a release proposing for comment amendments to its uniform net capital rule that, among other things, will substantially raise the minimum net capital broker-dealers will be required to maintain. The release will also standardize the haircut deductions for equity securities used in calculating net capital.

B. Penny Stock Task Force

1. Rulemaking. Fraudulent, high pressure telephone sales of low priced over-the-counter securities have become a major problem in the securities markets. As part of the Commission's effort to

reduce these problems, the Division developed Rule 15c2-6, adopted in August, 1989, which requires broker-dealers recommending low-priced, non-NASDAQ over-the-counter securities to new customers to obtain prior written agreement to the first three trades and to document their determination that the securities were suitable for the customer. The Commission also proposed amendments to Rule 15c2-11, which would require a broker-dealer to review specified issuer information in its files prior to initiating or resuming quotations for certain over-the-counter securities.

2. Broker-Dealer Examination Program. The Division's examination program has responded to increased penny-stock sales abuse by targeting for cause examinations those broker-dealer firms that are identified as conducting a substantial amount of penny stock activity. The Commission's regional offices have started 180 and completed 124 examinations at firms identified as primarily engaging in a penny stock business. Referrals to regional office enforcement groups have been made for 75 (60%) of the completed examinations. An additional 7 (6%) of the completed examinations have been referred to the NASD for possible enforcement consideration. Presently, there are 318 firms on the penny stock list.

C. Options Multiple Trading

The Commission adopted Rule 19c-5 to eliminate barriers to the competitive trading of options on equity securities in multiple markets ("multiple trading"). Specifically the rule provides that: (1) as of January 22, 1990, all newly listed options may be multiply traded and up to 10 previously listed options may be multiply traded, and (2) as of January 1, 1991, all options may be multiply traded. Contemporaneous with the adoption of Rule 19c-5, the Commission approved publication of a Division White Paper discussing certain market structure concerns traditionally associated with multiple trading (e.g., market fragmentation and best execution concerns), and describing several possible approaches that would address such concerns.

D. Bank Securities Activities

Bank regulators increasingly have interpreted the Glass-Steagall Act to allow banks to engage directly in securities activities, yet banks continue to be excepted from broker-dealer (and investment adviser) regulation under the

securities laws. With the Office of General Counsel, the Division has prepared, and the Commission submitted to the 100th Congress, legislative proposals (The Bank Broker-Dealer Act of 1987, S. 1175, H.R. 2557) to require banks to conduct most securities activities in separate subsidiaries or affiliates subject to broker-dealer regulation. Subsequently, the Commission reached the agreement with bank regulators set forth in Title III of S. 1886, The Proxmire Financial Modernization Act of 1988.

Recent approvals of the Federal Reserve Board have required that expanded bank activities be conducted in registered broker-dealer affiliates. These entities are new entrants to the business that are extraordinarily well placed to be competitive with the major investment bankers. The examination program must take account of these new competitive pressures.

E. Arbitration

In light of recent Supreme Court decisions upholding the validity of arbitration clauses in customer account agreements, the Commission has become responsible for assuring the procedural fairness of SRO arbitration systems, which currently receive more than 6,000 cases a year. Accordingly, changes to the arbitration procedures of the SROs will continue. Recently, the Commission approved rule changes to the exchanges' and NASD's arbitration rules designed to improve procedural fairness and to improve disclosure concerning predispute arbitration agreements. The Division will continue to work with the SROs to improve procedural fairness and will inspect the NYSE arbitration program in the near future to assess the modified arbitration rules.

F. Municipal Securities Disclosure

Municipal issuers are not subject to the securities law disclosure requirements applicable to corporate securities. The Commission's investigation of the Washington Public Power Supply System default showed that the disclosure responsibilities of underwriters of municipal securities were much less clearly recognized than those for underwriters of corporate securities. Problems also existed in municipal issuer disclosure in offerings. To address these problems, the Commission in June 1989 adopted Rule 15c2-12 requiring underwriters to obtain, review, and make available to investors issuer offering documents in municipal offerings of over one million dollars. It also published an interpretation of the responsibility of municipal underwriters to review issuer offering documents.

In response to this initiative the Municipal Securities Rulemaking Board proposed to establish a central repository for such documents. The staff is actively reviewing that proposal and coordinating with representatives of state and local government.

G. Automated Trading Systems

The Commission has determined that it is desirable to foster competition among various types of trading systems. In January 1989, the Commission approved the clearing agency registration of Delta Options and determined not to object to the Division's no-action position enabling RMJ Securities to operate without the over-the-counter trading system registering as an exchange. RMJ Securities operates information dissemination and trade execution facilities for over-the-counter options on government securities, and Delta Options clears trades in such options. The CME and CBT, which trade futures, and options on futures, on government securities, filed petitions in the Seventh Circuit challenging the Commission's actions. The case was decided on August 17, 1989. The Court dismissed the challenge to the no-action letter, and remanded the clearing agency registration order to the Commission for a determination concerning whether the system constitutes an exchange (with the order to be vacated 120 days from issuance of the Court's mandate). See discussion below in Section IX.

In April, 1989, the Commission proposed Rule 15c2-10, which would establish a new limited registration and regulatory regime for proprietary trading systems. The Commission expects to revisit this proposal this fall. The comment period for this proposal ended on August 2, 1989.

H. Index Participations

The CME, CBT, and CFTC (as amicus) have challenged the Commission's approval of Phlx, Amex, and CBOE rule proposals to trade Index Participations, a new security product which effectively allows an investor to take a position in a basket of stocks. The Seventh Circuit set aside the Commission's order on August 18, 1989. See discussion below in Section IX. The case reflects continuing ambiguities regarding SEC and CFTC jurisdiction.

I. Shareholder Disenfranchisement

On July 7, 1988, the Commission adopted Rule 19c-4 under the Securities Exchange Act of 1934. The Rule prevents an

exchange from listing (and an inter-dealer quotation system from including) any common stock or equity security of a domestic issuer that issues any security, or takes other corporate action, with the effect of nullifying, restricting, or disparately reducing the voting rights of its common stock shareholders. The Rule was part of a four year process that began after the New York Stock Exchange decided to end its one share, one vote requirement for listed companies. The Rule is designed for the limited purpose of preventing public companies from disenfranchising shareholders of their voting rights, and is not intended to restrict or interfere with the States' ability to regulate the corporate affairs of their issuers. After adoption of the Rule, the Business Roundtable filed suit against the Commission in the Court of Appeals for the D.C. Circuit to set aside the Rule. Briefs will be filed in September, and oral arguments are slated for November 20, 1989.

V. INVESTMENT ADVISERS AND FINANCIAL PLANNERS 9/

A. Resource Concerns

The enormous growth of the investment advisers industry has placed significant strain on the limited resources of the Division of Investment Management. In order to provide for effective administrative and enforcement of the Investment Advisers Act, the Commission has initiated two proposals:

1. The Commission has submitted to Congress a legislative proposal to create a system of self-regulation for investment advisers.

2. The Commission has published for comment a rule proposal to exempt small, state-regulated advisers from federal regulation.

B. Financial Planners

Various proposals have been made to subject all financial planners (whether or not they are "investment advisers" within the meaning of the Advisers Act) to federal or state regulation. The Commission has not supported federal regulation of all financial planners.

C. Proxy Voting

The Department of Labor has taken the position that ERISA requires an investment adviser to a pension plan to consider

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9/ See Section XI of the briefing materials.

the best economic interests of the plan's beneficiaries in voting proxies. The Commission may wish to consider whether the Advisers Act imposes similar responsibilities.

D. Performance Advertising

The Division is considering whether to propose more uniform standards for measurement of past performance in advertising by investment advisers.

E. Foreign Advisers

More than 200 foreign advisers, with no place of business in the United States, are registered with the Commission. These foreign advisers, among other things, provide money management services to U.S. pension plans and investment companies investing in foreign securities. Efforts to develop reciprocal arrangements with foreign regulators have not yet been successful. The SRO proposal may provide a solution, since SRO officials presumably could carry out inspections on foreign soil, by contractual agreements with their members, without causing the problems that would arise if Commission staff sought to conduct inspections in foreign jurisdictions.

VI. INVESTMENT COMPANIES 10/

A. Self-Regulation

Investment companies and their advisers are not included in the Commission's pending SRO proposal for advisers. Instead, the Division of Investment Management is pursuing discussions of the need for self-regulation with the investment company industry as a separate matter.

B. Disclosure Issues

The Commission and the Division are considering various proposals to help ensure that investors are given better information about key aspects of investment company products at or before the point of sale. Examples are:

1. The Commission recently proposed to require prospectus disclosure about the identity of closed end fund portfolio managers, and the Division plans to recommend a comparable requirement for open end funds. The Division is working on a proposal to require annual disclosure to

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10/ See Section XI of the briefing materials.

shareholders of fund management's evaluation of its own performance.

2. The Division is working with representatives of the unit trust industry to develop a uniform method of fairly measuring and displaying anticipated investment returns to unit holders. Similar work was done with the industry to develop uniform yield calculations for open end funds, and was implemented by Commission rule in 1988.

C. Asset Backed Securities

Various "securitized" products are not entitled to a statutory exemption from the Investment Company Act of 1940, but cannot operate as envisioned by their creators under the Act. The Division is developing a proposed rule to provide an exemption from the Act for collateralized mortgage obligations. The Commission has granted numerous exemptions by order for these and similar pooled products, such as the U.S. government loan sales. The Comptroller of the Currency would like the Commission to do the same for "bad banks," but as long as the OCC grants these entities liquidating bank charters, bankers have no incentive to seek 1940 Act exemptions from the Commission.

D. Glass-Steagall Act

There have been various legislative proposals to amend the Glass-Steagall Act to permit banks to underwrite investment company shares. The Commission has supported this change, subject to limited conditions worked out with the bank regulators. The investment company industry opposes Glass-Steagall repeal, but if it is repealed, the industry seeks reciprocal entry into all aspects of the banking business and amendments to the 1940 Act to guard against perceived potential abuses, such as name confusion (e.g., between a money market mutual fund and an insured bank money market account) and the use of bank affiliated mutual funds to make investments benefitting the bank or its other customers.

E. Mutual Fund Safety

Given the enormous growth and popularity of money market funds, and their use by investors as a functional equivalent to insured bank accounts, the industry and the staff have some concern about ensuring that money market fund investment practices continue to preserve principal values and liquidity. Money market fund growth and fierce competition for higher yields have led some funds to take

higher risks, by investing in riskier commercial paper and actively trading portfolio securities. Examples include four money market funds which held Integrated Resources commercial paper at the time of IR's default. In those cases, the fund managers agreed, and fortunately were able, to bear the losses. The industry is obviously concerned about the impact on investor confidence in money market funds as a whole which could occur if just a few ran into trouble. Commission staff and an industry task force are looking into steps that could be taken to solve the problem without unnecessarily impairing fund managers' flexibility.

Junk bond funds, given changes occurring in the markets for high yield securities, also raise concerns about fund portfolio valuations and liquidity. It is unclear whether investors really understood the risk disclosure they were given.

F. Transnational Sale of Investment Company Shares

As a practical matter, the 1940 Act bars most foreign investment companies from selling shares in the United States, and U.S. tax law makes the offer of U.S. fund shares unattractive in many countries. In addition to changes in the federal securities laws, tax, banking and state law changes likely will be needed to put the U.S. investment company industry on a competitive footing with foreign funds. At present, the U.S. industry does not seem interested in opening up U.S. markets to foreign funds until it has figured out what it needs as a quid pro quo to be able to compete overseas.

Today, U.S. fund managers are able to do business in many foreign countries by establishing funds domiciled in those countries and selling their shares overseas. The Commission, in turn, allows foreign money managers to register as investment advisers with relative ease, and they manage a number of the nearly 200 foreign portfolio U.S. investment companies that are sold in this country, usually in conjunction with a U.S. broker-dealer or fund complex.

G. Distribution Expenses

Last summer, the Commission proposed changes to Rule 12b-1, which governs the use of mutual fund assets to pay for distribution expenses. The Commission's proposal met fierce industry opposition. The industry has urged the NASD to make some changes to its rules governing sales charges to address some of the concerns underlying the Commission's proposal.

H. Reexamination of Regulatory Structure

A more global issue is whether it is time to reevaluate the entire regulatory structure to which investment companies and other pooled investment products are subject. In doing this, consideration should be given to removing the disparities between the way U.S. investment companies are regulated as compared to similar products offered in foreign countries and to U.S. bank common and collective trust funds. This is a subject that the Commission has not had the resources to tackle. However, the Investment Company Institute has undertaken a study of the issue.

VII. PUBLIC UTILITY HOLDING COMPANIES 11/

A. Repeal

Efforts to repeal the Public Utility Holding Company Act of 1935 so far have failed. The Commission does not have the staff to enforce the Act, and it interferes with FERC's efforts to introduce more competition into the nation's energy policy and also with the utility industry's desire to change and diversify operations. There have also been various legislative proposals to amend the Act in various limited ways and various proposals by the utility industry to engage in new and different ways of doing business.

B. Diversification by Utility Holding Companies

In February 1989, the Commission proposed a rule which would establish safe harbors for exempt intrastate public utility holding companies seeking to diversify into non-utility businesses. The rule proposal has been severely criticized by the utility industry as unnecessary and unduly restrictive. Diversification proposals by registered systems are being dealt with on a case-by-case basis, as registrants seek required Commission approval for particular transactions.

VIII. ENFORCEMENT MATTERS 12/

A. Principal Program Areas

The Enforcement Program is administered by the Division of Enforcement and the Regional Offices. Their principal and

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11/ See Section XV of the briefing materials.

12/ See Section V of the briefing materials.

continuing challenge is to prosecute successfully a sufficient number of significant enforcement actions to deter violations in the Commission's principal program areas. These areas are:

1. Financial disclosure violations and financial fraud. This area includes false and misleading disclosures by issuers of securities and others in connection with periodic reports of public companies, registration statements and prospectuses and other publicly filed reports pertaining to public companies. These cases frequently allege improper recognition of income, overstatement of inventories, and inadequate internal accounting controls. The Commission also investigates improper professional conduct by accountants and others who appear before the Commission with a view to disciplinary proceedings and recommends the commencement of disciplinary proceedings. Examples of recent actions include:

   a. SEC v. Donald D. Sheelen, et al. -- alleged overstatement of income between $15 and $27 million.

   b. SEC v. Rocky Mount Undergarment Co., Inc., et al. -- alleged $607,000 overstatement of net income.

2. Fraud and other violations by brokers, dealers, investment advisers and investment companies. These matters comprise a major segment of the Commission's enforcement cases. Many cases arise from the broker-dealer examinations conducted by regional offices and allege violations of the financial responsibility and books and records provisions.

   Other major cases concern illegal trading or sales practices. One recent proceeding, In the Matter of Salomon Brothers, Inc., alleged the trading of approximately $12.5 million in unmarked short sale transactions on October 19, 1987. In another recent proceeding, SEC v. Matthews & Wright Group, Inc., et al., the Commission alleged, among other things, violations of the internal controls and antifraud provisions involving over $1.3 billion in sham closings in municipal bond underwritings.

Investment adviser cases frequently involve such violations as commingling client funds, or use of funds for the adviser's benefit.

3. Securities offering cases. These cases involve the offer and sale of securities in violation of the registration provisions and may also involve misrepresentations concerning the use of proceeds from the offering, the risks involved, and the return on investment. These account for a significant portion of the enforcement cases brought each year. Examples of recent actions include:

   a. SEC v. Louisiana Real Estate Equity, Ltd., et al. -- sale of $65 million in investment contracts involving condominiums.

   b. SEC v. William A. Bartlett, et al. -- sale of over $8 million in investment contracts in a dairy leasing program.

   c. SEC v. Arthur R. Miller, et al. -- sale of $4.3 million in interests in a mortgage account.

4. Insider trading. In addition to the Drexel and Milken litigation and related investigations discussed below, the Commission investigates and litigates a significant number of other insider trading cases of significant but lesser magnitude each year. Approximately twenty-five such cases were filed in court during the past fiscal year. Examples of recent such cases include:

   a. SEC v. Hurton, et al., alleging that a paralegal at a major law firm provided to others material non-public information concerning a proposed merger and leveraged buyout of a client corporation. The tippees traded and tipped others. The complaint alleges that defendants purchased over 65,000 shares of stock for gross profits totalling $823,825.

   b. SEC v. Hellberg, et al., alleging that an individual provided his father with information concerning a proposed tender offer for the parent company of his employer. The complaint alleges that the father

purchased options in the parent company, realizing profits of approximately $328,844.

c. SEC v. Golenberg, et al., alleging that a professional investment adviser provided associates with non-public information concerning the proposed leveraged buyout of one client and merger of another client. The tippee traded on the information and shared the information with others, including a registered representative who traded on behalf of clients. The case, which was settled, resulted in disgorgement of over $742,000, and civil penalties exceeding $1,061,000.

The Insider Trading and Securities Fraud Enforcement Act of 1988 authorized the Commission to seek civil penalties from controlling persons of insider traders and to pay bounties to informants who provide information leading to the imposition of insider trading civil penalties. In June 1989, the Commission promulgated regulations governing the administration of the bounty program.

5. Market manipulation, including fraud in the penny stock market. Penny stock fraud includes such things as the sale of fraudulent blind pool offerings, the use of fictitious officers and directors, nominee accounts, excessive markups, false press releases on issuer activity and predetermined pricing in secondary trading. These cases involve local, national and international schemes of manipulation. The Commission recently filed an action, SEC v. Kimmes, et al., which alleged an extensive scheme to manipulate and distribute certain penny stocks that defrauded investors in the U.S. and abroad of several million dollars.

6. Violations concerning changes in corporate control. These cases allege violations of the reporting and other provisions of the Williams Act and those portions of the proxy provisions of the Exchange Act which govern changes in corporate control. Several recent cases illustrate this area:

a. SEC v. Drexel Burnham Lambert, Incorporated, Michael R. Milken, et al., alleges a series

of failures to disclose beneficial ownership as required by Section 13(d) of the Exchange Act in corporate control contests.

b. In the Matter of George R. Kern, alleges that an attorney was the cause of an issuer's failure to comply with the requirements of Section 14(d) of the Exchange Act concerning the issuer's response to a tender offer. This matter is pending before the Commission.

c. SEC v. Paul A. Bilzerian, et al., alleges the failure to disclose secret interests in securities of several corporations which were the subject of hostile takeover attempts. Three of the four defendants have settled this action and disgorged over $3 million in profits. Active litigation continues with Mr. Bilzerian.

B. Principal case challenges

1. Insider trading and related violations. The Commission's pending civil action against Michael and Lowell Milken and others, the implementation of the settlement with Drexel Burnham Lambert, Incorporated, investigations of other possible violations by employees and customers of Drexel and other investigations of possible violations by major market participants growing out of information obtained from Ivan F. Boesky, Boyd Jefferies, Martin Siegel and others consume the largest percentage of the Division's resources of any single group of cases.

2. Penny stocks. The Commission is engaged in a comprehensive program to increase its enforcement actions against penny stock manipulators and to coordinate these efforts with federal and state criminal law enforcement authorities, state securities regulators, and self regulatory organizations and the National Association of Securities Dealers. This effort is taking an increasingly large percentage of the Division's and Regional Offices' enforcement resources.

3. Internationalization. As the securities markets become more global, the Commission is faced with the need to enforce the federal securities laws regardless of the location of the violators and the evidence or proceeds of the violation. The

Commission has developed Memoranda of Understanding with various foreign countries to support and enhance these efforts and has established a specialized unit of attorneys to provide expertise for managing its international cases and negotiations. See discussion, above in Section I(D).

C. Applying and improving available enforcement remedies to securities law violations

1. Improved remedies. The proposed Securities Law Enforcement Remedies Act would enable the Commission to seek monetary penalties against persons who violate the securities laws in addition to its traditional civil remedies for an injunction and disgorgement of illicit profits or other ancillary relief or, for registered persons such as brokers or investment advisers, a bar or suspension from association with a registered entity. In addition, the proposed Act would authorize the Commission to bar persons who are the cause of violations from service as officers or directors of public companies.

2. Criminal remedies. With the Commission's encouragement, the Attorney General has made securities fraud a priority for criminal prosecutions. To achieve this goal, the Division has provided major assistance to United States Attorneys throughout the country.

3. Increased sanctions. The Commission has sought increased sanctions in the cases it initiates, including disgorgement of illegal profits, stiffer administrative sanctions and, where applicable, civil penalties. As a result, defendants are contesting the Commission's enforcement actions far more aggressively. The Commission's litigation caseload has grown significantly and litigation has become more protracted. An increasing number of cases which ultimately settle require extensive, complex settlement negotiations, litigation of interim motions and intensive discovery preparation for complex litigation.

D. Resource challenges

The demands created by the Drexel and Milken cases, criminal prosecutions, the penny stock program,

increased litigation, and international enforcement efforts have increased the demands on the staffing and other resources devoted to the Enforcement Program.

E. Division management

Pending the appointment of a director, the Division of Enforcement is being managed by its five senior executive service personnel who meet regularly and who report to the Chairman on a regular basis. Each week one of the senior executive service employees is designated to serve as the contact person for inquiries from the Chairman, the Commissioners, other divisions and other persons.

IX. OTHER LITIGATION 13/

A. Appellate Proceedings

1. Board of Trade of the City of Chicago and Chicago Mercantile Exchange v. SEC, Nos. 89-1084 and 89-1449 (7th Cir. opinion issued August 17, 1989). The Chicago Board of Trade and the Chicago Mercantile Exchange filed petitions for review of two issues: (1) the Commission's vote not to object to the staff's issuance of a no-action letter to RMJ Securities, Inc. advising that the staff would not recommend that enforcement action be taken against RMJ for operating an over-the-counter government securities options trading system without registering it as a national securities exchange; and (2) a Commission order granting Delta Government Options Corporation (the entity serving as clearing agency for the system) temporary registration as a clearing agency.

The court agreed with the Commission that the issuance of the no-action letter was an unreviewable decision not to take enforcement action, and dismissed that case. With respect to the Commission's order granting Delta's application, the court reasoned that a Commission determination pertaining to the status of the system as an exchange was necessary to a decision as to whether, in light of Delta's actual business plan, Delta is able and likely to comply with the Exchange Act. Because the Commission's order

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13/ See Section VII of the briefing materials.

contained no determination as to the status of the system as an exchange, the court vacated the order, but deferred for 120 days the effectiveness of the judgment.

2. SEC v. Levine, No. 88-6294(L) (2d. Cir. Aug. 2, 1989). This case involves a dispute between the Commission and the IRS over the distribution of some $16 million obtained by the Commission as disgorgement in consent decrees entered in the insider trading cases involving Dennis Levine and one of his accomplices, Robert Wilkis. The IRS (and the State of New York) have taken the position that the total amount of the disgorged trading profits is subject to tax liens for unpaid taxes on those profits. The Commission has sought to preserve some of the disgorged money for compensation of defrauded investors. After negotiations between the IRS and the Commission broke down, the Commission had proposed a unilateral compromise to the district court which would have allocated about half of the disgorgement fund to state and federal taxing authorities. Both the IRS and the State of New York objected to the compromise plan. The district court overruled the tax objections and ruled that the entire fund should be impressed with a constructive trust for the benefit of defrauded investors and directed the Commission to submit a new plan for distribution to investors.

   On appeal, the Second Circuit reversed in a holding that will have the net effect of giving the entire fund to the IRS. The court rejected the constructive trust finding by the district court on the grounds that since the money had been surrendered as part of consent decrees, there had been no finding of wrongdoing on which a constructive trust could be based. Thereafter, the court upheld IRS tax liens imposed by jeopardy assessments made by the IRS, while the Commission was still in litigation against Levine, before the transfer by the defendants of money to the receiver appointed to take possession of the money. As to the balance, the court remanded the case to the district court for further proceedings as to the effect of a special statute giving the IRS a priority in equity receiverships.

   The Commission will be filing a petition for

rehearing and rehearing en banc on August 30, 1989.

3. Business Roundtable v. Securities and Exchange Commission, No. 88-1651 (D.C. Cir.). The Business Roundtable filed a petition for review challenging Commission Rule 19c-4 under the Exchange Act. That Rule adds to the rules of the national securities exchanges and the NASD a prohibition on the listing or continued listing of the common stock or other equity securities of a domestic issuer if the issuer issues securities, or takes other corporate action, with the effect of nullifying, restricting or disparately reducing the per share voting rights of any common stock of the issuer. The Rule was adopted by the Commission in July, 1988 in response to proposals by exchanges to modify long-standing rules regarding one share, one vote standards for all common stocks.

4. Chicago Mercantile Exchange v. SEC, petitions for review docketed, Nos. 89-1538, 89-1763, 89-1786, 89-2012 (7th Cir.) (argued June 9, 1989). As discussed above, the CME and CBT, Investment Company Institute, and the CFTC (as amicus) challenged the Commission's approval of proposals submitted by certain securities exchanges and the Options Clearing Corporation to trade, issue and clear novel, market basket products designated as "index participations" (IPs). The CME and CBT, in their petitions, contended that IPs are futures contracts subject to the exclusive jurisdiction of the CFTC and not securities, and that, therefore, the Commission did not have jurisdiction to approve trading in IPs. The Commission's briefs argued that IPs are not futures because they lack two essential characteristics of futures -- futurity and bilateral obligation. The briefs also urged that IPs are securities because they have the essential characteristics and economic substance of a number of instruments expressly included in the statutory definition of "security" and that the Commission reasonably concluded that IPs are within the statutory definition in the Exchange Act. The Commission's briefs also countered the argument made by the Investment Company Institute that IPs trading creates investment companies subject to regulation under the Investment Company Act of 1940.

On August 18, 1989, the Seventh Circuit held that the Commission lacked authority to authorize the exchanges to trade IPs, ultimately concluding that IPs are futures contracts. In reaching its conclusion the court stated that IPs do not fit into the paradigm of a future or a security, but are "novel instrument[s] *** that *** offer attributes previously missing in the market." The court reasoned that if deference were granted both to the Commission's determination that IPs are securities and to the CFTC's determination that IPs are futures, then IPs must fall under the exclusive jurisdiction of the CFTC. A petition for rehearing will be filed.

B. Amicus Curiae

1. Arthur Young & Co. v. Reves, No. 88-1480 (S. Ct.), cert. granted. The Commission has filed an amicus curiae brief in the Supreme Court urging reversal of an Eighth Circuit decision that certain demand notes are not securities. The notes were widely sold by a farmer's co-operative to its members and others in minimum denominations of $100 to fund the co-op's day-to-day operations and were marketed, as part of the co-op's "investment program," as "safe" and "secure" investments. The 8th Circuit concluded that the demand feature of the notes takes them out of the definition of security.

   The Commission's brief discusses the three tests used by the courts of appeals to determine whether an instrument is a "note" within the statutory definition of "security" -- the "commercial-investment" test, the "risk capital" test, and the "family resemblance" test -- and urges the Supreme Court to adopt the Second Circuit's "family resemblance" test.

2. Ceres Partners v. GEL Associates, et al., No. 89-7666 (2d Cir.). The Commission filed an amicus curiae brief urging that implied private actions under Sections 10(b) and 14(e), antifraud provisions of the Securities Exchange Act, be governed by a five-year limitations period drawn from Section 20A of the Exchange Act, added by the Insider Trading and Securities Fraud Enforcement Act of 1988. Most courts have traditionally applied state limitations periods to these provisions. However, recent Supreme Court

decisions establish that where applying state limitations periods to a federal claim frustrates or interferes with the implementation of the policy underlying the federal statute, the courts should decline to borrow state law when a rule from federal law provides a closer analogy. The Commission's brief argues that the state law borrowing approach has bred uncertainty, inconsistency and time-consuming litigation, thereby hampering private enforcement of the federal securities laws and wasting judicial resources. The Commission argues that a federal limitations alternative to Section 20A, a one year/three year provision applicable to the express remedies under the Securities Exchange Act, is not more analogous to the implied rights than is Section 20A.

C. Commission Bankruptcy Program

At an open meeting on June 8, 1989, the Commission authorized a review of its participation in reorganization cases under Chapter 11 of the Bankruptcy Code involving publicly-held debtor corporations. The goal of the review is to determine whether public investors receive adequate protection in corporate reorganizations and what impact the Commission's participation has on the reorganization process. The review also will seek to determine whether there should be changes in the Commission's role or in the statutory framework as it affects investors and the Commission's role. The review will not focus, however, upon the Commission's specific statutory responsibilities in Chapter 11 -- review of plan disclosure statements and policing for abuses of the Bankruptcy Code exemption from Securities Act registration.

To obtain additional information and data for the review, the Commission authorized active participation in a limited number of Chapter 11 cases. The staff is to present the results of its study to the Commission, including the progress in the active participation cases, by March 1, 1990.

D. Rule 2(e) Proceedings

The Office of the General Counsel litigates the Commission's disciplinary proceedings against professionals, including attorneys and accountants, under Rule 2(e) of the Commission's Rules of Practice. An increased number of financial fraud investigations by the Division of

Enforcement has correspondingly increased the number of these disciplinary proceedings against accountants.

E. EEO/Tatel Report

David Tatel, an independent EEO consultant, submitted a report making recommendations for improving the Commission's EEO process. The Office of the General Counsel and the Office of the Executive Director have been reviewing Mr. Tatel's report and intend to make a recommendation to Chairman Ruder shortly concerning implementation of the report's recommendations.

F. In re George C. Kern, Jr.

This administrative proceeding pursuant to Section 15(c)(4) of the Exchange Act arises from the effort by Campeau Corporation to acquire Allied Stores Corporation in 1986. It is alleged that Allied failed to comply with Section 14(d)(4) of the Exchange Act and Rule 14d-9 thereunder by failing to file a prompt amendment to Item 7 of its Schedule 14D-9 to disclose the existence of negotiations with a third party to sell certain assets, merger negotiations with a white knight, the existence of an agreement in principle on a merger agreement, and a resolution of Allied's board of directors concerning the merger agreement. (Allied, which was also a respondent in these proceedings, previously consented to an order under Section 15(c)(4).) It is alleged that Kern was a director of Allied and its outside counsel, and was given sole responsibility for making the decisions for Allied about filings under Section 14(d). Under Section 15(c)(4), the Commission may issue an order directing compliance against a person who fails to comply with Section 14, and any person who was "a cause of the failure to comply due to an act or omission [he] knew or should have known would contribute to the failure to comply."

This matter was tried before an administrative law judge. The law judge concluded that Allied was required to amend Item 7 of its Schedule 14D-9 to disclose each of the four events at issue, and that Kern was a cause of these violations. The law judge declined to issue an order of future compliance against Kern, however, because Kern was no longer in a position either to require Allied to make corrective filings or to control its future compliance, and he concluded that an order of general future compliance would be beyond the scope of Section 15(c)(4).

The Commission, on its own initiative, ordered review of the law judge's initial decision, and Kern also appealed. Among

the issues presented on appeal are: the circumstances under which an amendment to Item 7 of a Schedule 14D-9 is required; the question of when a person is "a cause of" another person's violation; and the scope of relief available against a "cause" under Section 15(c)(4) -- i.e., whether the section authorizes orders of general future compliance regardless of whether the "cause" remains affiliated with the person who committed the primary violation.

X. LEGISLATIVE DEVELOPMENTS

The Office of the General Counsel is involved in the consideration of various legislative proposals. Current legislative matters include the following:

A. International Securities Enforcement Cooperation

The Commission has submitted to Congress the proposed "International Securities Enforcement Cooperation Act of 1989" (S. 646 and H.R. 1396). This legislation would make inapplicable the disclosure requirements of the Freedom of Information Act for certain confidential documents received from foreign authorities; clarify the Commission's authority to provide access to its records; authorize the Commission to sanction persons based upon the findings of a foreign court or securities authority; authorize self-regulatory organizations to bar persons convicted of any felony from the securities industry; and permit the Commission to accept reimbursement for expenses incurred in assisting foreign securities authorities.

B. Securities Law Enforcement Remedies

As discussed above, the Commission has submitted to Congress the proposed "Securities Law Enforcement Remedies Act of 1989" (S. 647 and H.R. 975). This legislation would authorize new enforcement remedies, including imposition of civil money penalties against securities law violators in the Commission's administrative proceedings and civil actions. The legislation also would authorize, in the Commission's administrative proceedings pursuant to Section 15(c)(4) of the Exchange Act and in civil actions brought by the Commission, bars and suspensions of persons from service as an officer or director of any reporting company. In addition, the legislation would expand the bases for administrative proceedings under Section 15(c)(4) of the Exchange Act to include violations of Section 16(a) of that Act, which imposes stock ownership reporting requirements on officers and directors of issuers.

C. RICO Reform

The Commission has expressed support for H.R. 1046, the RICO Reform Act of 1989, which generally would limit private civil RICO damages to actual damages.

D. Insider Trading Definition

In the 100th Congress, the Senate Securities Subcommittee considered various definitions of insider trading, including one submitted by the Commission. Various developments, including the Supreme Court's decision in Carpenter v. United States, and passage of the Insider Trading and Securities Fraud Enforcement Act of 1988, have reduced Congressional interest in a statutory definition of insider trading.

E. Tender Offer Legislation

The 100th Congress considered a number of legislative proposals affecting the regulation of tender offers. The Commission has generally opposed such legislation, but has supported reducing the reporting window under Section 13(d) of the Exchange Act to two business days.

F. Glass-Steagall Reform

The Commission has supported legislative efforts to repeal or modify the Glass-Steagall Act, so long as adequate safeguards are enacted to address the investor protection concerns arising from increased bank securities activities. As discussed above, the Commission negotiated an agreement with the banking regulatory agencies in 1988 concerning a proposed regulatory scheme for certain bank securities activities if Glass-Steagall is repealed. This agreement was included as Titles III and IV of S. 1886.

XI. ECONOMIC STUDIES 14/

The Office of Economic Analysis is engaged in several projects to study market phenomena as well as the economic impact of past or contemplated Commission actions.

A. Leveraged Buyouts

OEA is empirically examining several issues concerning leveraged buyouts (more precisely, going private transactions), including (1) the pattern of going private

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14/ See Section XVII of the briefing materials.

activity, over time and across industries, (2) characteristics of firms that go private, (3) the structure of financing in going privates, (4) the level of reported fees and expenses in going privates, (5) the effects of going privates on bond prices, (6) the importance of asset sales following going privates, and the effects of these asset sales on employment, (7) the effects of going private on corporate cash flows, tax payments, expenditures on research and development, capital investments, and employment, and (8) management conflicts of interest in going private transactions. Also, OEA is empirically examining the extent to which shareholders are presently disadvantaged in going private transactions that do not require Rule 13e-3 disclosures. (Expected Completion Date - September 1989)

B. Stock Price Volatility

OEA has three pending studies on stock price volatility:

1. Margin Policy and Stock Price Volatility. This study empirically examines the relationship between margin requirements for both stocks and stock index futures on trading volume and price volatility in the stock market during the past sixty years. (Expected Completion Date - October 1989)

2. Program Trading and Stock Price Volatility. This study examines the relationship between different types of program trading and stock price volatility (Expected Completion Date - November 1989)

3. Institutional Investors and Stock Price Volatility For a large sample of companies, this study examines the relationship between the percentage of equity owned by institutional investors and three variables: trading volume, stock price volatility and bid-ask spreads. (Expected Completion Date - December 1989)

C. Rates of Returns, Expense Ratios and 12b-1 Fees

This study examines the relationship between 12b-1 fees and expense ratios for a large sample of open-end funds during 1986 and 1987. (Expected Completion Date - September 1989)

D. Effect of SEC on Bankruptcy Proceedings

In cooperation with the Office of General Counsel, OEA is empirically examining the effect of the Commission's

participation in bankruptcy proceedings on bankruptcy costs and the division of claims among private creditors, public creditors, and public stockholders. (Expected Completion Date - March 1990)

E. Goodwill Accounting and Corporate Takeovers

This study empirically examines whether different international accounting standards concerning the treatment of goodwill in takeovers puts U.S. firms at a competitive disadvantage vis-a-vis foreign firms in takeover contests for U.S. companies. (Expected Completion Date - March 1990)

F. Stock Transfer Tax

This study documents the history of both federal and state stock transfer taxes, and examines the effects of these taxes on trading volume and stock price volatility. (Expected Completion Date - March 1990)

G. Institutional Investors, Corporate Takeovers and R&D

This study empirically examines a popular argument often made by critics of corporate takeovers, namely that the growth of institutional ownership of equity and the threat of corporate takeovers induces corporations to forego long-term investments in research and development and capital projects. (Expected Completion Date - December 1989)

H. Pension Terminations and Corporate Takeovers

This study examines the relationship between corporate takeovers and pension terminations, and the extent to which these terminations are used to finance takeovers. (Expected Completion Date - September 1989)

I. Use of Financial Theory in Enforcement Cases

OEA is preparing a manuscript that describes the use of modern financial theory in securities litigation and surveys relevant empirical studies in the financial economics literature. (Expected Completion Date - December 1989)

J. Disclosure of Yields on Unit Investment Trusts

OEA is working with the Division of Investment Management on the development of policy guidelines concerning the disclosure of yields on unit investment trusts. (Expected Completion Date - December 1989)

XII. BUDGET AND ADMINISTRATION 15/

A. Self-funding

In July 1987, the Securities Subcommittee of the Senate Committee on Banking, Housing and Urban Affairs directed the SEC to study the possibility of transforming the agency from appropriated to self-funded status. The self-funding study prepared by the Executive Director was submitted to the Subcommittee in January 1989. The study offered five specific proposals designed to improve recruitment and retention. The proposals would give the Commission the authority to:

1. Set staff salaries that would take into account competitive salary differentials and would provide regional pay differentials.

2. Offer retention bonuses to professional staff based on performance.

3. Fill 100 positions at compensation up to Level IV of the executive pay scale for highly qualified lawyers, accountants, or other professionals for specific cases or program management.

4. Develop and implement pay bands for classifying professional and support staff positions.

5. Lease space itself and obtain exemptions from GSA space management regulations in order to meet specialized Commission requirements.

Other federal agencies, including other financial regulatory agencies, already enjoy flexibility in pay systems or space management or both. For example, the Federal Reserve Board is empowered to hire staff without regard to existing civil service requirements. The Federal Reserve Board, the Commodity Futures Trading Commission and others all lease and manage their own space.

In addition to the personnel recommendations and at the request of Congressman Dingell, three options for additional fees to be collected by the Commission were identified.

1. Increase the Registration Fee Under Section 6(b) of the Securities Act of 1933.

15/ See Section I of the briefing materials.

2. Apply the Section 31 Transaction Fee to OTC Trades in NASDAQ-NMS Securities.

3. Increase the Section 31 Transaction Fee Rate.

The self-funding issue is still active in both houses, but has taken on the appearance of primarily an effort to increase fees and use the additional revenue as a mechanism to allow increased appropriations for the SEC. The five personnel recommendations are still under discussion, but have encountered resistance by some members of Congress who do not want individual agencies improving their own personnel situation outside of an overall improvement in the civil service.

B. Authorization request for 1990 - 1992

The Commission is currently authorized through the end of fiscal 1989. Hearings on the agency's authorization have occurred in the House and Senate but final action has not yet been taken. Interaction between Commission and Congressional staff suggest that the Congress will approve the agency's request for 1990 and 1991 at $178.0 million and $212.6 million respectively. These are the amounts requested. The options for increased fees are being actively considered as part of the authorization.

C. 1990 Budget Request

The President's budget for 1990 includes $168.7 million for the Commission. On July 13th the House Appropriations Subcommittee deferred action on the Commission's 1990 budget request. The deferral is the result of the Subcommittee's decision to only consider the appropriations for agencies with an enacted authorization. The Commission is not currently authorized beyond 1989. In discussing the deferral, Congressman Smith, Chairman of the Subcommittee, indicated that the funding decision for the Commission will be made during the conference between the House and Senate. No action above the subcommittee level has occurred in the Senate.

D. EEO/Tatel Report

The agency needs to take final action on the recommendations submitted by David Tatel. The staff has reviewed all findings and recommendations and is prepared to advise the Chairman regarding the adoption of recommended actions.