

CHAIRMAN'S OFFICE
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Office Memorandum • SECURITIES AND EXCHANGE COMMISSION

DATE: July 23, 1965
SEC. & EXCH. COMM.

TO : Chairman Manuel F. Cohen

FROM : Arthur E. Pennekamp, Regional Administrator
San Francisco Regional Office

SUBJECT: Cost Reduction Goals - Fiscal Year 1965-66

Arthur E. Pennekamp

In response to your letter of July 7, 1965, the San Francisco Regional Office submits the proposals hereinafter set forth. The proposals are summarized in Exhibit A attached hereto.

A. INCREASED PRODUCTIVITY AND EFFICIENCY

(1) Investment Company Inspection Program

It is proposed to eliminate two positions, an attorney GS-11, and an analyst GS-5 heretofore allocated to the investment company inspection program. This will result in a savings to the Commission of an aggregate of \$12,220 per year.

For the reasons hereafter stated, it is believed that these two positions can be eliminated without prejudice to the attainment of the goals heretofore set for this program.

When the inspection program was first instituted, the operating budget for the region was increased to allow for the employment of four persons. Due to the necessities of recruitment and training, it was not until the fiscal year just ended that the program became operative in this region. Through the combined efforts of the personnel in the region and additional personnel furnished by the Division of Corporate Regulation, a total of 10 inspections were completed. During the year there were two attorneys and one analyst assigned to the program in this region, leaving an analyst

position open. One of the two attorneys resigned just prior to the end of the fiscal year. The operating budget submitted for the current fiscal year calls for a replacement of this attorney and an analyst to fill the pre-existing vacancy.

In this region there is only one investment company of substantial size, which was inspected during fiscal 1965 by representatives of the Division. 1/ We understand that recommendations are pending for the institution of proceedings, and it is assumed that no reinspection of this company will be scheduled in the immediate future.

The quota set by the Division for this region for fiscal 1966 is eight inspections, which allows a month and a half for each inspection. With the experience and know-how acquired by the attorney and the analyst presently assigned to this program, they should be able to equal or exceed the goal which has been set, especially since the companies to be inspected are comparatively small in size and since there will be available to the inspectors the annual reports on Form N-1R to assist them in discovering violations and other irregularities.

In the event that an inspection indicates the necessity of further investigation looking toward formal enforcement proceedings, it is anticipated that emergency assistance may be provided from the general enforcement staff.

It is further anticipated that as the number of companies initially inspected has increased, and technical violations eliminated, the reinspections will be less time consuming. It is therefore to be hoped that the proposed reduction in personnel will be permanent.

1/ Insurance Securities Incorporated

- (2) Application of Automatic Data Processing to analyses of accounts of customers of broker-dealers suspected of having been "churned"

The proposed operating budget for this region for fiscal 1966, contains an item of \$500 to be expended for programming ADP equipment to analyze customer's accounts of broker-dealers suspected of having been "churned" i.e. overtraded. It is proposed to investigate the possibility of making ADP equipment and personnel of other agencies available for this purpose.

The Commission has adopted the so-called "Looper formula" as the basis for determining whether over-trading has occurred. This involves, among other computations, the determination of how long a security purchased in the account has been held; whether a profit or loss (realized or unrealized) has occurred and the amount thereof; the amount of commissions paid or the amount of profit to the broker-dealer on the transactions; dividends received and interest paid; the net amount of the customer's investment (original amount plus any additions and minus withdrawals); the average amount invested and the number of times the amount of the investment has been "turned over".

Since the basis for suspicion of churning arises from the existence of a large number of transactions in a particular account, it is apparent that an analysis involving so many different calculations with respect to each account is most time consuming when performed in the ordinary manner by an analyst. Furthermore, once an account is shown to have been churned, it usually becomes necessary to analyse other accounts of the same firm or of the same salesman in order to determine the extent of the practise and the persons responsible therefor. This may involve months and even years of effort.

As a result, pressure of other matters often results in investigation of churning matters being deferred, or inadequately investigated.

Discussions with William Becker have resulted in the preliminary conclusions (1) that it is feasible to "program" a computer, compatible with that being obtained by the Commission, to make the necessary computations; (2) that once the "program" is worked out it may be used on the same or compatible computers located in different parts of the country; and (3) that Mr. Becker's staff, because of other priorities, will not be able to work on programming for this purpose for two or three years.

General Services Administration has commenced a campaign to make full use of computers operated by various agencies in metropolitan areas, including the San Francisco area. Some of these agencies have personnel capable of programming.

Since the program, once laid out, can be used in other computers, it could be used by other regional offices.

It is impossible to assign a dollar value to the savings which would accrue, although the savings in time should be considerable, to say nothing of the opening of areas of investigation not usually explored because of the labor involved.

(3) Procurement of Equipment

During the last fiscal year, both the San Francisco and Los Angeles offices have had some success in obtaining, without cost, various pieces of equipment declared surplus by other agencies.

It is proposed that this program be intensified in the current fiscal year, particularly in the Los Angeles office, in contemplation of the removal of that office from its present location in leased quarters to larger quarters in a government owned building. Since the removal is not expected to take place until fiscal year 1967, equipment will be obtained as it becomes available, in anticipation of the requirements for next fiscal year.

Inasmuch as it is impossible to predict how much, if any, equipment will become available under this program, it is impossible to predict the amount of savings which will accrue.

SECURITIES AND EXCHANGE COMMISSION
SUMMARY REPORT
COST REDUCTION PROGRAM

DIVISION OR OFFICE

San Francisco Regional Office

DATE

July 23, 1965

GOALS AND PROGRAMS, PROJECTS, OR ACTIONS TO ACHIEVE THEM	ANNUAL SAVINGS GOALS				ESTIMATED ANNUAL SAVINGS FROM ACTIONS TO DATE IN REPORTING YEAR						OTHER BENEFITS 1/	PROPOSED USE OF DOLLAR SAVINGS 2/
	Man-Years		Dollars		Man-Years			Dollars				
	CY	NY	CY	NY	CY	NY	BNY	CY	NY	BNY		
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)
Reduction in personnel assigned to Investment Company Inspection Program	2	2	\$12,220	\$12,220								
Application of Automatic Data Processing to analyses of accounts of broker-dealers suspected of having been "churned"												
Procurement of Equipment												
Space Utilization												

Savings Key:

- A - Apply to production of more units of work.
- B - Apply to raise quality of service or performance.
- C - Use to finance some other approved program or activity.
- D - Return to Commission general fund to allocate to other programs or to place in reserve.

Abbreviations:

- CY—Current fiscal year
- NY—Next fiscal year
- BNY—Beyond next year

- 1/ Check and explain in narrative report.
- 2/ Use Savings Key and explain in narrative report.