during the suspension period. Because of the publicity generally accorded the period of suspension as opposed to other aspects of the sanction, misunderstanding has resulted concerning the consistency of Commission sanctions.

The Committee recommends that the Commission give consideration to the desirability and practicability of employing money penalties, or fines, as a sanction in broker-dealer proceedings. We are advised that a study of the potential use of money penalties by federal administrative agencies is currently being made by the Administrative Conference of the United States. Fines are a type of sanction currently being employed in broker-dealer proceedings by the self-regulatory organizations. We believe that the availability of money penalties would provide the Commission with substantially greater flexibility in fashioning a suitable remedy in this type of proceeding. Fines, if employed as a sanction, should not be permitted to become routine lest they come to be considered a cost of doing business.

Section 9(a)(2) of the Investment Company Act prohibits any person from serving in certain capacities in relation

to a registered investment company if he has been enjoined, permanently or temporarily, from further misconduct in connection with the purchase or sale of any security. The disqualification under that section becomes effective upon entry of the court's order and extends automatically under Section 9(a)(3) to any company with which the person enjoined is affiliated. Although the Commission, upon application, can grant an exemption to a person or company disqualified under those sections, during the Commission's consideration of any such application an investment company could be deprived of the services not only of the person enjoined but also of its investment adviser and principal underwriter.

We believe that the immediate, automatic bar imposed by those sections is an unduly harsh remedy the application of which as a practical matter might be contrary to the best interests of the investment company's shareholders. It has also impeded prompt settlement of cases which would otherwise warrant such treatment. Furthermore, the disqualification of a company under Section 9(a)(3) for the conduct of an affiliated person

might under some circumstances raise a constitutional question.

The Committee recommends that the Commission seek legislation repealing those sections. The Investment Company Amendments Act of 1970 added a new subsection (b) to Section 9 of the Act authorizing the Commission to bring a proceeding for the purpose of barring a person or company, temporarily or otherwise, from acting in any of the capacities to which an automatic disqualification would apply under Sections 9(a)(2) and 9(a)(3). We believe that if Section 9(b) were broadened by amendment to include as an additional ground for temporary or permanent disqualification the existence against the person named in the proceeding of an injunction of the kind contemplated by Sections 9(a)(2) and 9(a)(3), an automatic disqualification under those sections would no longer be necessary, and the Commission would have before it all the issues and thus greater flexibility in fashioning an appropriate sanction.

VI. Investment Companies and their Advisers

The Committee recommends that the Commission reorganize its inspection and enforcement program for investment companies

and their advisers. In 1962, in recognition of the special knowledge, skills and techniques required to monitor the activities of investment companies on a continuing basis, the Commission transferred inspection and enforcement functions to the Division of Corporate Regulation. Because of the absence of adequate manpower, however, on the average the cycle of investment company inspections has exceeded 10 years. Chairman Casey has stated that under ideal circumstances registered investment companies should be inspected on the average at least once every two years.

Pursuant to the Investment Company Amendments Act of 1970, advisers to investment companies must register for the first time with the Commission under the Investment Advisers Act. We recommend that the Commission adopt a program which would be specifically tailored to investment companies and their advisers and that separate inspection units with specially trained personnel be assigned to appropriate regional offices. These units would be charged with most, if not all, inspections, investigations and enforcement activities affecting investment company complexes in the regions under their jurisdiction.

Routine, coordinated inspections would develop greater awareness of legal requirements on the part of the investment company managers, bring to light such problems as inadequate capitalization of advisers and unfair trading and other practices and lead in the long run to a reduction in the number of formal enforcement proceedings relating to investment companies and their advisers. An effective surveillance program would also serve to maintain a high level of investor confidence in the investment company industry.

Inspections of investment advisers of all types are now usually performed by field personnel assigned to the regional offices. In view of the complexity of the investment company regulatory structure and the unique nature of the business and operations of investment company advisers (as compared, for example, to investment advisers whose sole business is the publication and sale of market letters) the Committee recommends that the inspection program for investment company advisers be integrated into the overall program of investment company inspections currently being conducted by the Division of Corporate Regulation. That Division would seem best equipped to assume the

combined function, since its present processing, inspection, regulation and enforcement responsibilities already directly affect investment company advisers.

The desirability of consolidating inspection functions suggests the possible advantage to the Commission (and convenience to advisers) of combining all investment company adviser responsibilities into a coordinated program of investment company - investment adviser regulation, which would include not only inspections but also enforcement activities concerning such advisers as well as the interpretation and administration of the Investment Advisers Act as it relates to them. Furthermore, a number of broker-dealers are registered under the Securities Exchange Act of 1934 whose business is primarily that of underwriting investment company securities. For reasons similar to those expressed above in the case of investment company advisers, the Commission should consider the feasibility of consolidating the administration of statutory responsibilities with respect to such underwriters into the suggested overall program of investment company regulation.

VII. Coordination of Enforcement with Other Agencies

Although the Commission bears the primary responsibility for protecting investors against fraudulent practices, some of the burden is shouldered by state securities authorities, the United States Attorney's offices in the several districts, the Postal Service and the self-regulatory organizations. While there is a substantial measure of cooperation between the Commission and these other agencies, better coordination of efforts would in our view result in more effective enforcement.

A. State Securities Agencies

State authorities are handicapped in developing proof of violations and obtaining jurisdiction over violators in cases where a significant portion of the unlawful conduct occurs outside the boundaries of a particular state. On the other hand, these agencies are well situated to take prompt and effective action when these activities are localized. While local authorities have developed ad hoc working relationships with the Commission's various regional and branch offices, the Commission should strive to implement a better overall coordination of efforts. Although the legal authority and responsibilities of state administrators vary from state to state, each can benefit

to some extent from the expertise and information available to the Commission. The Committee recommends that the Commission reemphasize to its Regional Administrators the importance of maintaining a close and continuing liaison with the state administrators in their respective regions. The Committee further recommends that in keeping with the practice followed in the past, state securities officers be invited to participate in Commission training programs and that training materials be made generally available to them. With regard to broker-dealer inspections the Regional Administrators should, in conjunction with the Office of Broker-Dealer and Investment Adviser Examinations, to the extent practicable, continue to develop their inspection programs in cooperation with the state authorities, the exchanges and the NASD with a view to expanding the number of broker-dealers inspected, avoiding duplication of effort and coordinating any resulting formal enforcement action.

B. Federal Authorities

Criminal violations of the federal securities laws are prosecuted by the U. S. Attorneys in the several districts

after approval by the Attorney General. Although the Commission is not authorized by law to prosecute criminal violations, criminal cases are developed through investigations by the Commission's staff, are instituted as the result of a criminal reference by the Commission and usually require extensive participation by the staff in the indictment and trial stages. The Committee believes that better coordination between the Commission, the Justice Department and the U. S. Attorney's offices would result in more efficient handling and disposition of criminal cases.

Criminal cases are usually developed by a staff attorney under the supervision of a Branch Chief with the oversight and guidance of the Regional Administrator. Once a case is developed, the staff attorney, with the assistance of the Branch Chief, reviews the matter and prepares a criminal reference report. The criminal reference report is then reviewed by the Regional Administrator and, if approved, forwarded to the office of Criminal Reference in the Division of Trading and Markets where it is reviewed by a Branch Chief and then approved by the Assistant Director in charge of that office. Depending on the nature of the case, the report may also be reviewed by the

Associate Director or the Director. If the Division approves the reference, a memorandum summarizing the nature of the offense and the proof is prepared and submitted first to the General Counsel and then to the Commission for their approval. If the Commission approves the recommendation, the criminal reference report is delivered to the Securities Fraud Unit, Criminal Division of the Justice Department. Prosecution of the case is not commenced until that Unit has reviewed the report and referred the matter to a U. S. Attorney in an appropriate federal district.

The process by which a criminal matter is developed and brought to trial in our judgment invites unnecessary delay. We recommend that the Commission confer with appropriate representatives of the Department of Justice with a view to shortening the period of time between the initial staff determination that a criminal reference is warranted and presentation of the matter to the Grand Jury. The disposition of criminal cases could also be expedited by improved communication between the Commission's staff, the Securities Fraud Unit and the local U. S. Attorney's office. Procedures should be adopted to screen

potential criminal cases at an early stage of the investigation. The recent assignment of staff members of the Securities Fraud Unit to each regional office should eliminate prolonged and intensive investigation of cases that will not be recommended for prosecution and assist in the development of required proof.

Except in districts where the U. S. Attorney's office has developed a special unit to prosecute securities cases, the U. S. Attorney may require the assistance of the Commission's staff in preparing a case for trial. Many U. S. Attorneys' offices are overburdened with a number of complex matters or lack experience in the preparation and trial of securities cases. Also, in most instances, virtually the entire investigation has been conducted by the Commission's enforcement staff. We understand that many U. S. Attorneys request and welcome participation by members of the Commission's staff in the prosecution of securities cases. The Committee suggests that the Commission consider with the Justice Department the desirability of having staff attorneys appointed in appropriate cases as Special Assistants to the U. S. Attorney. Under the procedure we contemplate the staff attorney appointed would normally be one

who had spent a substantial amount of time developing the facts supporting the criminal reference report and would therefore be most familiar with the matter. Although the extent of his participation would be within the control of the U. S. Attorney, the staff attorney, by reason of his appointment, would be able to participate directly in the Grand Jury presentation and could provide such other assistance as may be appropriate.

C. Self-Regulatory Organizations

The stock exchanges and the NASD are authorized by statute to adopt and enforce rules of conduct affecting their members. They share with the Commission the additional responsibility of assuring compliance by their members with the requirements of the securities laws. Each of the major self-regulatory organizations maintains a sizeable staff of examiners and enforcement personnel. Each undertakes its own inspections and investigations, conducts disciplinary proceedings and in appropriate cases imposes a fine or other sanction for misconduct. The Commission presently lacks the authority to enforce the rules of the self-regulatory organizations against their members directly or to review or alter disciplinary actions

taken by the stock exchanges. Its power to review decisions in NASD disciplinary proceedings is limited.

The Commission has proposed certain modifications in the self-regulatory system designed to make it more effective. These proposals would authorize the Commission to exercise additional and closer regulatory oversight over the rule-making authority of the self-regulatory organizations, the enforcement of their rules and the administration of disciplinary proceedings conducted by them. The Committee believes that adoption of proposals along the lines suggested in the Commission's Study of Unsafe and Unsound Practices of Brokers and Dealers would help to remedy defects in the self-regulatory system brought to the fore by the back office crisis of 1968-70, remove certain inconsistencies in its authority with respect to the stock exchanges and the NASD and better integrate the enforcement activities of the Commission and these organizations.

In order for the self-regulatory system to realize its full potential there must be a commitment on the part of the Commission and of the self-regulatory organizations to make it work. The self-regulators must demonstrate their determination to achieve effective regulation over their members by adopting

rules and procedures that will protect investors and assure compliance. The Commission should encourage these efforts and should lend its support by developing better communication and cooperative action among these agencies.

Because all broker-dealers are under the direct jurisdiction of the Commission and many are also under the jurisdiction of more than one self-regulatory organization, there is a danger of inconsistent and duplicative regulation of their activities. The Commission should play an affirmative role in allocating inspection and enforcement responsibilities among these agencies. The Committee recommends continuous efforts to coordinate both the timing and coverage of inspections and investigations by the Commission, the NASD and the stock exchanges. The Committee recognizes that the NASD and the exchanges often look for different things from those looked for by the Commission. Nevertheless, without formally ceding any of its overall investigative and enforcement powers, the Commission should attempt to work out allocations of primary responsibility. For example, it could charge the NASD and the stock exchanges with primary responsibility for checking

into accounting practices, debt ratios, spreads, margin requirements and churning. The Commission and the self-regulatory organizations may wish to consider the use of a technique developed by the Commission and the investment company industry whereby the independent public accountant is asked to examine into and report upon certain facets of the internal operations and procedures of persons and organizations subject to the jurisdiction of the Commission.

The Committee believes that a more routine exchange of information between the Commission and the self-regulatory agencies would result in more effective enforcement. We recommend that meetings be held on a periodic basis between their respective staffs for a mutual discussion of current regulatory and enforcement problems. These meetings would provide a useful forum for reviewing and if necessary revising the allocation of enforcement responsibilities.

The absence of adequate publicity concerning disciplinary proceedings conducted by the self-regulatory organizations tends to diminish public and investor confidence in the efficacy of

self-regulation and lessens the value of these proceedings as a means of establishing guidelines for the conduct of their members. Unlike the Commission, these organizations do not publicize findings of violation in all cases, and in proceedings that are publicly disclosed the release generally contains only a summary description of the violation and the sanction imposed. The Committee recommends that the Commission request the self-regulatory organizations to reconsider their policies governing the publicity given to disciplinary proceedings. We believe that in order for these organizations to play an effective, coordinate role in the self-regulatory system their procedures and the standards on which their decisions are based should be opened to public scrutiny.

VIII. The Commission's Need for Additional Manpower

The Committee believes that in order for the Commission to continue to perform its overall responsibilities effectively it must grow in size. It must have substantially larger numbers of skilled personnel and added resources in order to meet the demands placed on it by a burgeoning community of issuers, intermediaries and shareholders and the rising tempo and

complexity of securities transactions. The Commission must process and examine an ever-increasing number of registration statements, proxy statements and periodic reports, oversee the activities of a sophisticated community of broker-dealers and the self-regulatory organizations of which they are members and regulate a growing corps of investment companies and investment advisers. Performing these tasks and undertaking investigative and enforcement action against apparent violators already impose a serious strain on available resources. Yet these activities represent only the routine business of the Commission.

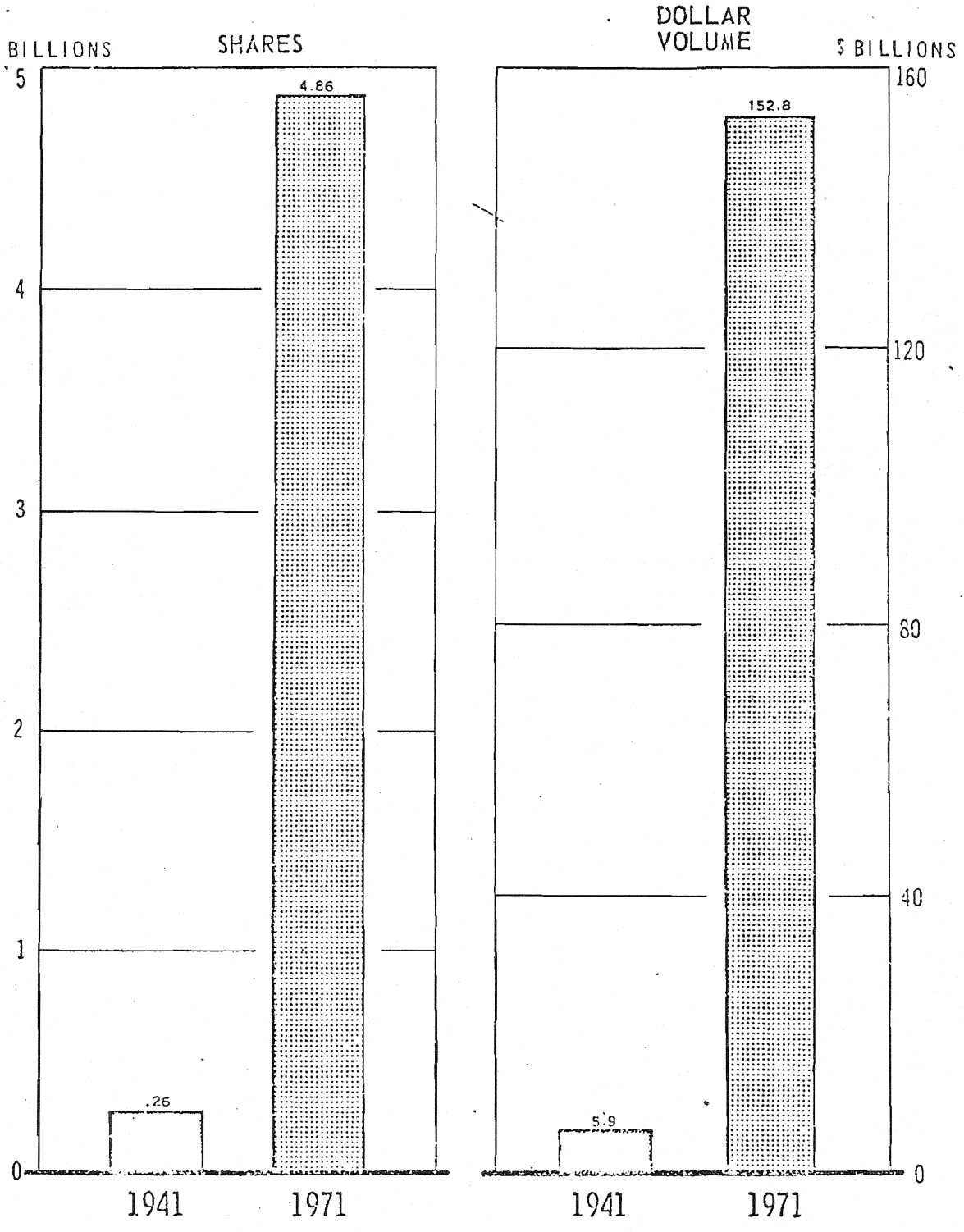
In discharging its responsibilities, the Commission should be in a position to anticipate emerging conditions that might adversely affect the proper functioning of our capital markets. Having done so, it should be able to develop appropriate regulatory and enforcement programs and determine the most effective allocation of its own resources before a crisis emerges. The financial and operational difficulties experienced by the brokerage community several years ago illustrate the kinds of problems that might be obviated if the Commission were in a position to maintain a planning staff on a continuing basis.

The Commission should have the capability of assessing long range business and economic research conducted by others in order to anticipate economic, financial and technological trends and of making its own research contribution, particularly in areas directly related to the operation of the securities markets. The Commission recently published its policy statement on the future structure of the securities markets, but these markets will continue to evolve in new and unexpected ways under the impact of increased institutionalization and internationalization.

Other matters of equal consequence will also require intensive consideration. For example, the Commission is only at the threshold of developing a comprehensive program for the immobilization and ultimate elimination of the stock certificate. In the Committee's view, the Commission is confronted with responsibilities of a new dimension by reason of the vast changes that have been taking place in the capital markets and the securities industry in recent years. These added burdens, together with a staggering increase in its day-to-day workload, point directly to the need for substantial enlargement of the Commission's staff and capabilities.

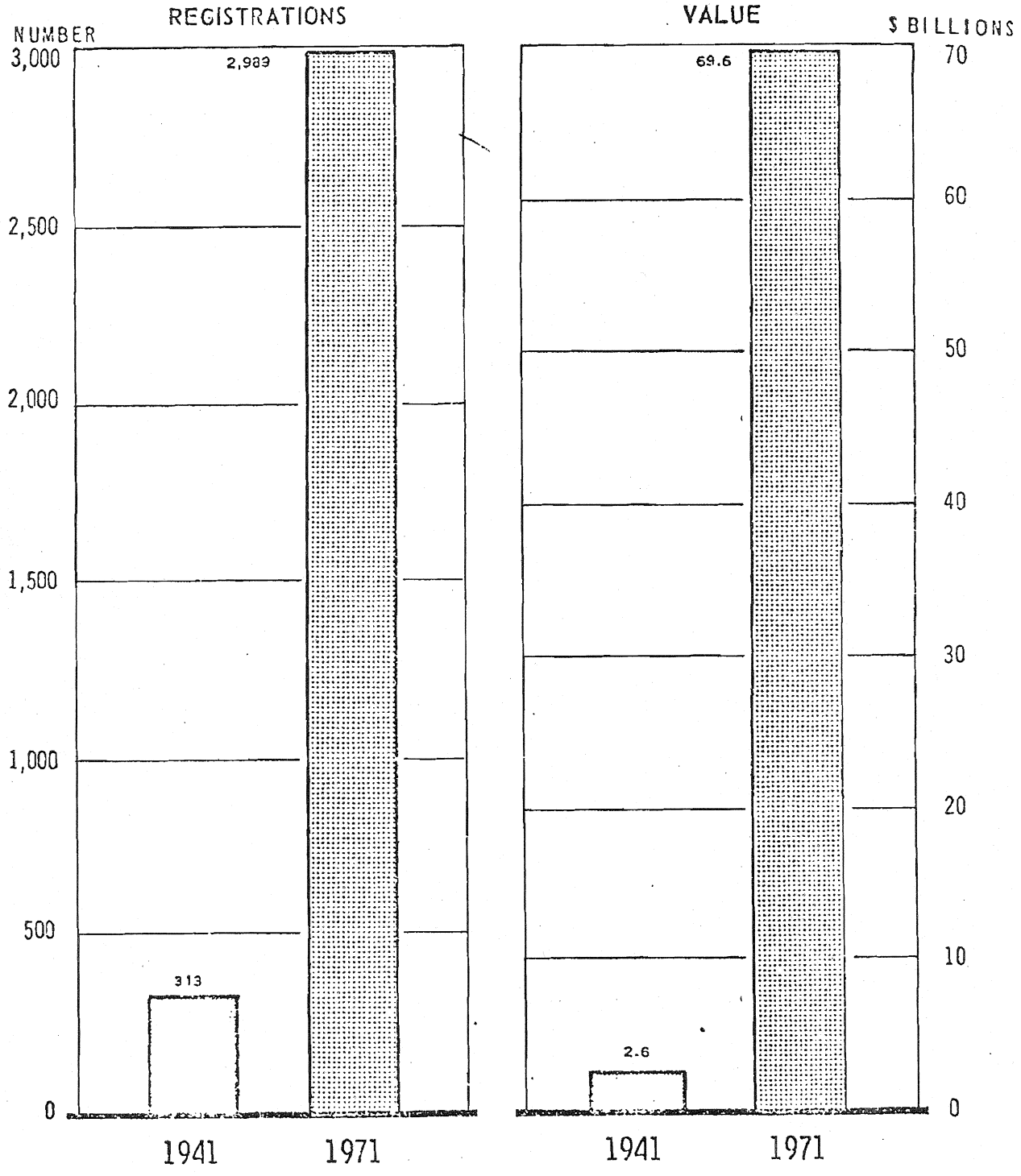
The Committee found it highly instructive to compare the size of the Commission's staff in June 1941 with its size in June 1971, over 30 years later, and then to look at the changes in the Commission's responsibilities over the same period. The selection of the 1941-1971 period was not fortuitous. By 1940, with the adoption of the Investment Company and the Investment Advisers Acts, Congress had completed the basic framework for regulation of the securities industry. The Committee found that over that period the Commission's staff had actually declined in numbers from 1,711 to 1,410. While more members of the Commission's staff in 1941 were engaged in the administration of the Public Utility Holding Company Act of 1935 than were so engaged in 1971, the present staff level still seems unwisely low in light of the dramatic expansion of the Commission's other regulatory responsibilities. This observation is sustained by the charts that follow:

EXCHANGE TRADING

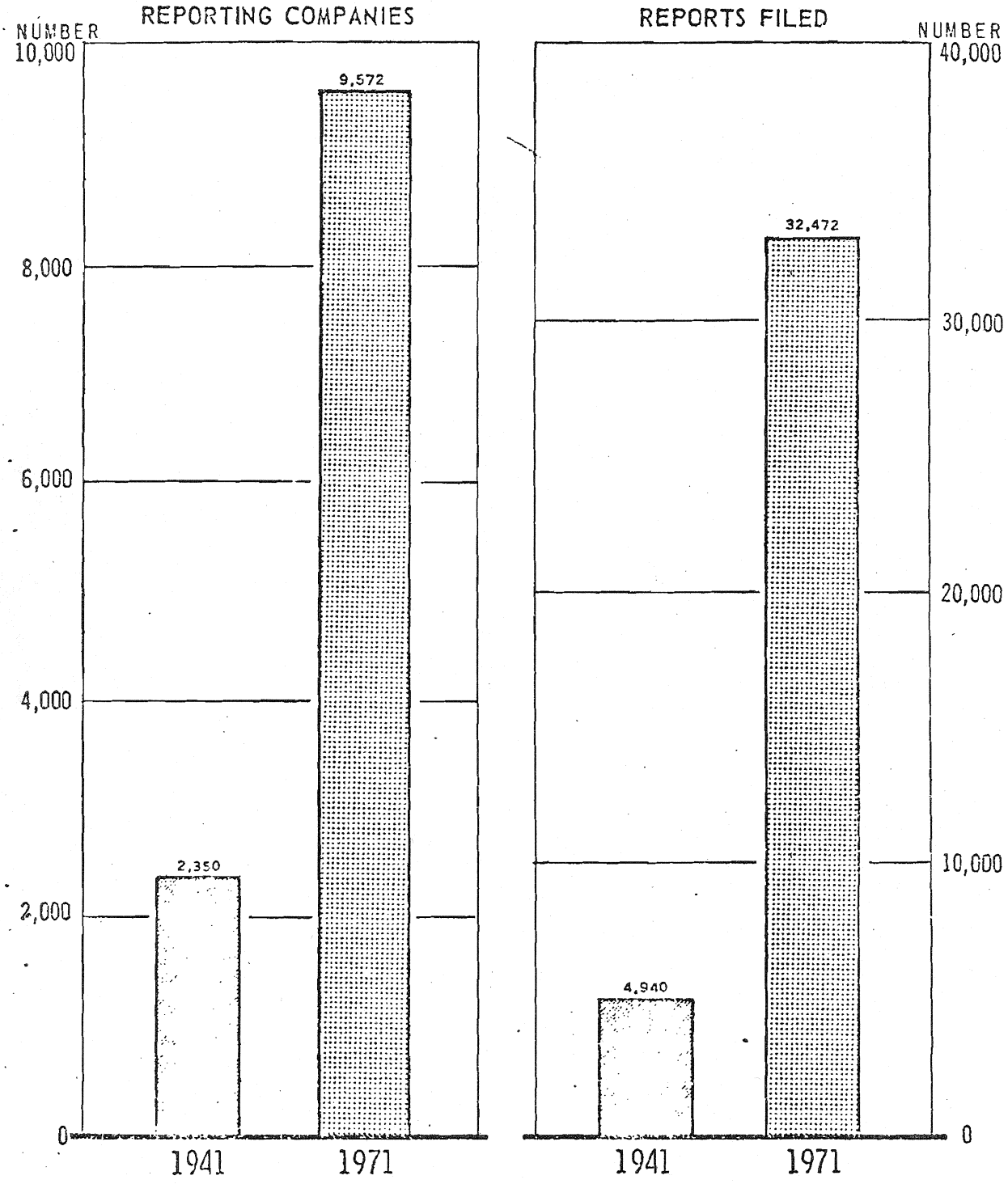


DS 5028

1933 ACT REGISTRATION STATEMENTS EFFECTIVE

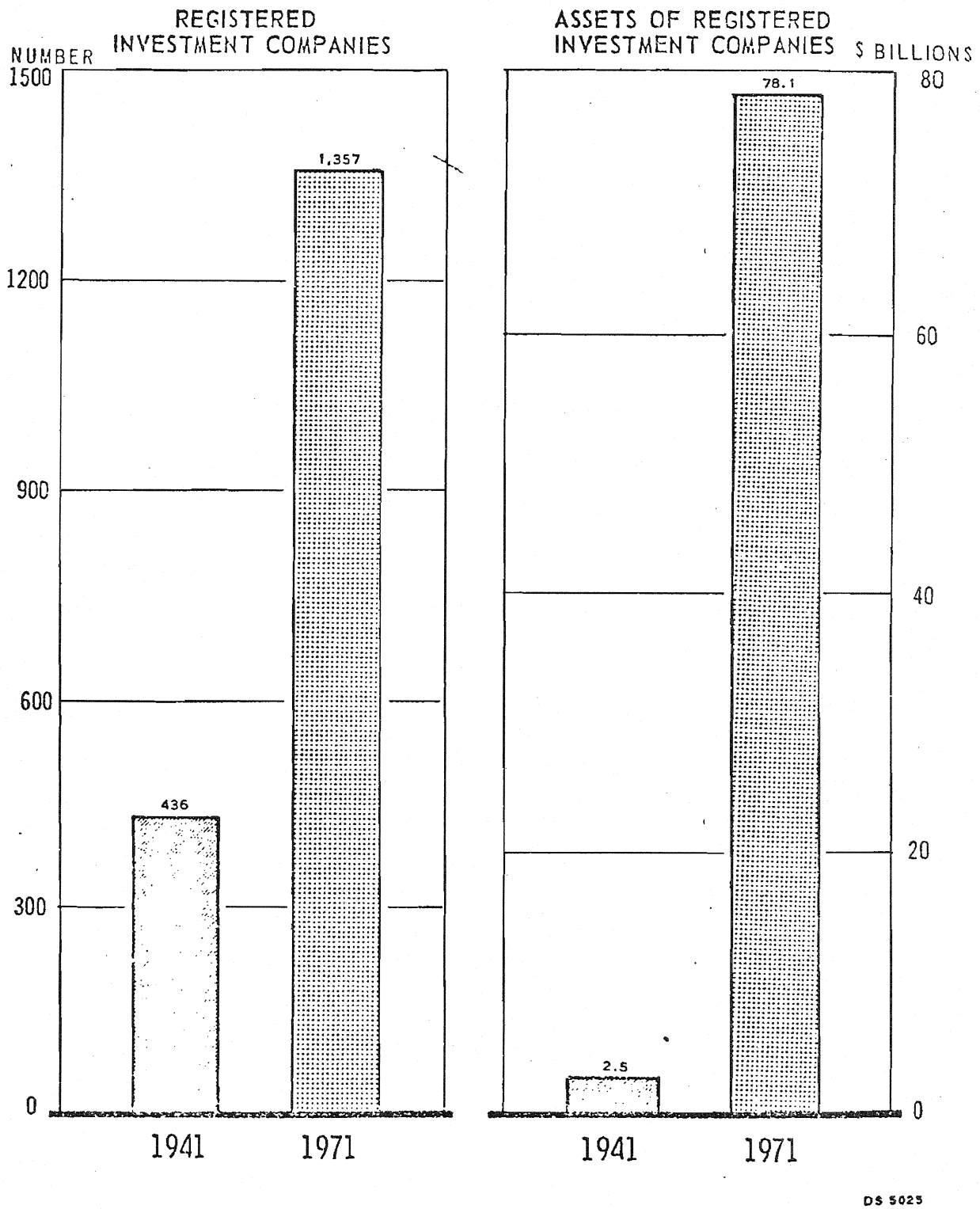


REPORTS UNDER THE 1934 ACT

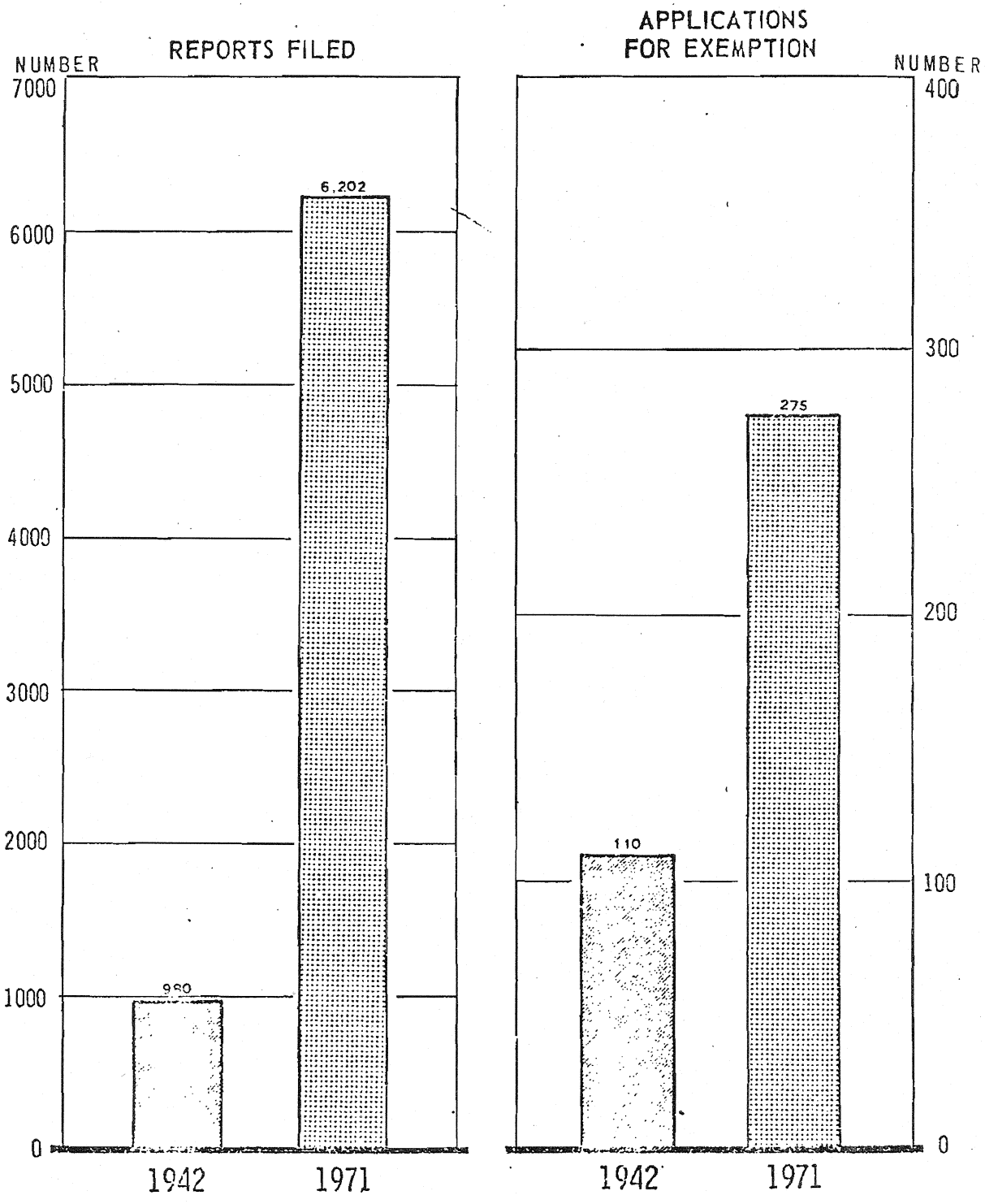


DS 5026

REGISTERED INVESTMENT COMPANIES



INVESTMENT COMPANY ACT OF 1940



DS 5024

The expanding workload in recent years in virtually every area of the Commission's activities should have been met by the employment of additional personnel to review and comment on required filings, inspect broker-dealers, investment companies and investment advisers, develop improved coordination with self-regulatory organizations and process the flow of routine applications. While the establishment of priorities and expedited procedures has enabled the Commission to concentrate on matters of particular urgency, the need to adopt these measures is a reflection of the mounting and what we believe to be excessive demand on the Commission's existing resources.

The burden has not been any less great in the area of formal enforcement. Recent years have witnessed a steady expansion of the application of the antifraud provisions of the securities laws to new types of transactions and new classes of defendants. Under those provisions the Commission has vigorously attacked the proliferation of "shell" companies, improper use of inside information, improper use of customers' funds and securities by brokers, infiltration of organized crime into the securities industry, unlawful corporate take-

overs, misuse of pension fund assets and manipulative securities promotions on a national and an international scale. In the Committee's view, these enforcement activities are indispensable to an effective program of securities industry regulation and should be expanded and made more effective.

The Committee did not undertake the kind of review that would be necessary to determine the appropriate size or shape of the Commission in the years ahead. A study of that nature is more properly the concern of the Commission itself and the budgetary authorities in the Executive and Legislative branches of the Government. Our general impression, however, is that the Commission should establish a goal of doubling the size of its total staff over the next five years.

June 1, 1972

John A. Wells, Chairman
Manuel F. Cohen
Ralph H. Demmler

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