

SECOND ANNUAL REPORT 1972



SECURITIES INVESTOR PROTECTION CORPORATION 485 L'ENFANT PLAZA, S.W. SUITE 2150 • WASHINGTON, D.C. 20024 (202) 484-5400

LETTER OF TRANSMITTAL SECURITIES INVESTOR PROTECTION CORPORATION

Washington, D. C. April 16, 1973

The Honorable G. Bradford Cook Chairman Securities and Exchange Commission 500 North Capitol Street, N. W. Washington, D. C. 20549

Dear Chairman Cook:

On behalf of the Board of Directors I submit herewith the Second Annual Report of the Securities Investor Protection Corporation pursuant to the provisions of Section 7(c)(2) of the Securities Investor Protection Act of 1970.

Respectfully,

D. Woodside

Chairman

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SECURITIES INVESTOR PROTECTION CORPORATION (SIPC)

Directors

		Term expires December 31
Byron D. Woodside	Chairman	1973
George J. Stigler, Vice Chairman	Professor of Economics, University of Chicago, Chicago, Illinois	1972
Glenn E. Anderson	President, Carolina Securities Corporation, Raleigh, North Carolina	1972
Henry W. Meers	Vice Chairman, White, Weld & Co., Incorporated, Chicago, Illinois	1974
J. Charles Partee	Adviser to the Board and Director, Division of Research and Statistics, Board of Governors of the Federal Reserve System, Washington, D. C.	1974
Samuel R. Pierce, Jr.	General Counsel, Department of the Treasury, Washington, D. C.	1973
Donald T. Regan	Chairman, Merrill Lynch, Pierce, Fenner & Smith Inc., New York, N. Y.	1973

Bruce K. MacLaury, then Deputy Under Secretary for Monetary Affairs, served as a director representing the Department of the Treasury from January to July, 1971.

Andrew J. Melton, Jr., then Chairman, Executive Committee, Smith, Barney & Co., Inc., New York, N.Y., served as a director for the term expiring December 31, 1971.

Staff Officers

Theodore H. Focht General Counsel—Secretary

> Wilfred R. Caron Associate General Counsel

Lloyd W. McChesney Vice President—Finance

Torm

John B. Bourne Manager—Accounting and Assessments

Thomas R. Cassella Manager—Operations and Examination of Liquidations SIPC was created by the Securities Investor Protection Act of 1970, a federal statute which became effective December 30 of that year. It is a nonprofit membership corporation. It is not an agency or establishment of the United States Government and it receives no appropriation of government funds. Under certain circumstances it has authority to borrow from the United States Treasury (see page 14). The directors are appointed by "government" (see page 8).

The membership of SIPC is composed of all brokers or dealers registered under the Securities Exchange Act of 1934 and all members of a national securities exchange (other than those whose business consists exclusively of one or more of four categories, see page 7). At the end of 1972 there were approximately 3,750 SIPC members.

SIPC's primary purpose is to provide financial protection within the limits specified in the Act for customers of failing brokers or dealers who are members of SIPC. The protective provisions of the Act work in various ways for the benefit of customers of failing firms. For example, if a customer's fully paid securities are held by a broker-dealer firm which fails, these securities, if they are on hand and identifiable as the customer's fully paid for property, are to be returned to the customer without limit as to their dollar value.

If a customer has a net equity claim on the date a liquidation proceeding begins (see "filing date," p. 19), SIPC shall, if necessary, advance funds through the trustee conducting the liquidation in amounts necessary to cover the customer claims up to a maximum of \$50,000 for each customer except that in the case of claims for cash, as distinct from securities, not more than \$20,000 may be paid with funds advanced by SIPC.

It should be noted that SIPC does not protect a customer from a decline in price resulting from an unwise purchase or an adverse movement in market prices. It is intended to protect the customer, in the event his broker-dealer firm fails, against the loss of securities or cash balances owing to him on the filing date, based on the situation as it exists on that date, up to the above mentioned statutory limits. Customers also may receive certain benefits indirectly under the Act as a result of SIPC's advances, if necessary, to complete certain types of open contractual commitments which had been entered into by the failing firm in the ordinary course of business in which customers had an interest. It also should be noted that SIPC does not have the power to prevent the failure of broker-dealer firms nor can it employ its funds for this purpose.

Funds required for the protection of customers of SIPC members are provided by assessments on the SIPC member firms. These assessments are currently at the rate of $\frac{1}{2}$ of 1 percent of each member's gross revenues from the securities business. The member assessments from December 30, 1970 (inception) through December 31, 1972 aggregate approximately \$62,100,000, including \$5,670,000 of initial assessments based on 1969 gross revenues.

It is estimated that SIPC advances in the amount of \$18-23 million may ultimately be required to meet claims of customers and administrative expenses for the 64 firms in liquidation at December 31, 1972.

It is expected that the SIPC fund will be accumulated until it approximates \$150 million exclusive of lines of credit. The rate at which this can be accomplished, of course, depends upon many circumstances, including the health of the securities industry, the demands upon the fund for the liquidation of SIPC member firms, and the flow of assessments. As the fund increases in size, SIPC may vary assessment rates based on various considerations, including the type of business done and risk and experience factors.

The SIPC fund at any time consists of cash, United States Government or agency securities and confirmed lines of credit. At the end of 1972 the fund amounted to approximately \$105 million. Estimated assessments for the fourth quarter and adjustments based on 1972 revenues to be received after the year end aggregate \$7,310,000. Initially the fund included a confirmed line of credit in the amount of \$65 million with a group of 29 banks. Under the terms of the agreement the available credit declines each year, and expires in October 1976. On April 1, 1972 the credit was reduced to \$55 million and on April 1, 1973 it was further reduced to \$45 million.

If necessary for the protection of customers in the event of a crisis of extreme severity, SIPC may borrow from the Securities and Exchange Commission (SEC) which, in turn, will issue notes to the United States Treasury in amounts up to \$1 billion. In the event of such a borrowing, assessments on SIPC members would be applied to the repayment of the loan; except if the plan of repayment based on assessments would not repay the loan within a reasonable time, the Commission may impose a transaction fee not exceeding one-fiftieth of 1 percent of the purchase price of equity securities in transactions on national securities exchanges and in the over-the-counter markets.

The liquidation procedures of the Act represent a blending of many provisions of the Bankruptcy Act and the special provisions of the 1970 Act.

SIPC does not, itself, liquidate a failing firm. Upon receipt of a notice that a SIPC member firm is in financial difficulty or approaching financial difficulty, and upon the occurrence of certain other events specified in the Act, SIPC may apply to a federal court for the appointment of a trustee. If the court grants the application, the trustee will take possession of the premises and property of the debtor firm and carry out the applicable statutory objectives. In brief, these are to:

- a. return specifically identifiable property to customers entitled thereto;
- b. distribute to customers the fund of cash and securities held for the accounts of customers, and in advance thereof or concurrently pay to customers moneys advanced by SIPC, if necessary;
- c. operate the business of the debtor to complete open contractual commitments made in the ordinary course of business by the debtor firm where customers have an interest; and

d. liquidate the business of the debtor firm.

In connection with the foregoing, rights of subrogation may be enforced.

The Act specifically precludes the reorganization of a debtor firm. Accordingly, SIPC funds cannot be used to rehabilitate a firm, reorganize it, or operate it in the hope it may recover. The trustee has no choice but to liquidate and, once that process has started, it probably is irreversible.

On March 31, 1973 there were 79 firms in liquidation under the 1970 Act. The following table indicates the number of trustees appointed by quarter since the inception of SIPC through March 31, 1973:

	1971	1972	1973
1st Quarter	1	15	15
2nd Quarter	6	4	
3rd Quarter	6	8	
4th Quarter	11	13	
-	24	40	15

In addition applications were pending before the Courts in two cases including one in which the district court's denial of SIPC's application was on appeal to the Court of Appeals for the Second Circuit (See page 31).

Of the 64 firms in liquidation on December 31, 1972 trustees had substantially completed distributions of cash and/or securities to public customers in 32 cases as of that date as indicated in the following chart (See Appendix I, Part B for details):





As of December 31, 1972, a total of \$16,570,000 in cash and securities at filing date values had been distributed to customers: \$9,570,000 from debtors' estates and \$7,000,000 from SIPC advances. Approximately \$3,500,000 of the latter amount was for customers' credit balances and \$3,500,000 was for cash in lieu of missing securities. Details of these distributions are shown in Appendix I.

In the 32 firms where customer claims had been substantially satisfied, a total of \$10,690,000 in cash and securities at filing date values had been distributed: \$6,300,000 from debtors' estates and \$4,390,000 from SIPC advances. Approximately \$1,290,000 of the latter amount was for customer credit balances and \$3,100,000 for cash in lieu of missing securities. These figures indicate that SIPC had to provide approximately 41% of the funds required to satisfy valid customer claims.

The basic causes of the failures of the firms in liquidation are briefly summarized on pages 24-25 and in Appendix II.

Mismanagement, fraud and manipulation, lack of control due to poor books and records and the inexperience of principals, are prominent factors contributing to the failures of these broker-dealers. Action is being taken by the Commission, the selfregulatory organizations and other local authorities to proceed against principals who may have been culpable in these failures. In two cases principals have been convicted of criminal conduct (see page 31). In other cases, indictments have been handed down and trials are pending. Administrative proceedings by the Commission to determine whether or not persons should be barred from the securities industry have been begun in some instances, and are under consideration in others. In this connection, in aid of possible action under Section 10(b) of the Act, SIPC has forwarded to the Commission and the selfregulatory agencies, a list of names of persons associated with firms for which trustees have been appointed.

Notices of the appointment of trustees and claim forms were mailed to over 107,000 customers. Claims were received from 26,000 customers. There were 17,300 distributions of customers' specifically identifiable property, single and separate fund cash and securities and advances from SIPC valued at \$16,570,000. Of these customer claims, 23 were reported in excess of the \$50,000/\$20,000 limitation of SIPC coverage for advances, and were valued at \$1,249,000. These customers have been or may be paid \$730,000 by SIPC advances, and will have remaining claims against the single and separate funds and general estates of the debtor firms in the amount of \$519,000.

As of the end of March, SIPC had advanced \$9,129,000 to trustees to pay customers' claims, to complete open contractual commitments and to pay administrative expenses. As of the same date, trustees had distributed approximately \$11 million of cash and securities to customers from the assets held by the failing firms or received by the trustees for their accounts.

Finally, SIPC is not a regulatory agency, and therefore, is not a new regulatory layer in the structure of the securities industry. SIPC has only a small staff. It relies on the securities exchanges, the National Association of Securities Dealers, Inc., the Commission, the trustees, and industry sources for its information. It is subject to oversight by the Commission, and, of course, the Congress. SIPC has an advisory role in relation to the agencies just mentioned in matters concerning financial responsibilities of SIPC member firms and their reporting and inspection procedures and, in the exercise of that role, has commented upon many rule proposals by the Commission, the NASD, and the exchanges.

INTRODUCTION

The Corporation (SIPC) was created by the Securities Investor Protection Act of 1970, a federal statute which became effective December 30, 1970. Its principal purpose is to provide certain financial protections to the customers of failing brokers or dealers. The Corporation's role and method of operation can best be understood against certain background facts and events which were explained in some detail in its first annual report published in April of 1972.

In order to perform its primary role, SIPC has established and is accumulating a fund represented by assessments paid by its members based on their revenues from the securities business. This fund is, and in the future may be, supplemented if necessary by confirmed lines of credit. It is hoped that the fund as so constituted will at all times be sufficient for SIPC to discharge its responsibilities.

Although SIPC is not an agency or establishment of the United States Government, the ties between the two are close and continuing. Five directors are appointed by the President with the advice and consent of the Senate and two by government agencies. The activities of SIPC are subject to SEC and Congressional oversight. In the event the SIPC fund should be insufficient for its purposes, SIPC is authorized to borrow not in excess of \$1 billion through the SEC from the United States Treasury and arrange for a repayment plan subject to SEC approval. Finally, the 1970 Act recites that the provisions of the Securities Exchange Act of 1934 (unless otherwise provided) apply as if the 1970 Act was an amendment to the 1934 Act.

Advances are made by SIPC to trustees appointed by a federal court to liquidate failing broker-dealer firms. The trustee establishes the claims of customers for cash or securities and pays customers' cash and net equity claims with funds advanced by SIPC, if necessary, within the limits prescribed by the Act.

The liquidation is carried out under the special procedures of the 1970 Act which, while they draw upon certain aspects of the Bankruptcy Act, are quite different in their operation from the latter Act. These procedures give effect to the circumstances of the securities business and the intent of the Congress to make evident to investors the governmental concern with and commitment to the public interest and public confidence in our securities markets.

The extent to which certain of SIPC's activities must mesh with existing regulatory and self-regula-

tory organizations and procedures is demonstrated by a brief review of the manner in which the system has operated in a typical case.

Under existing regulations of the Commission, the exchanges and the NASD, financial and other reports are submitted by broker-dealer firms to one or more of the self-regulatory organizations to which they belong, i.e., the National Association of Securities Dealers, Inc., the national securities exchanges, and the SEC. The firms, likewise, are subject to inspections by the examiners of one or more of these organizations. The Act provides that when it appears to the Commission or any self-regulatory organization that a broker or dealer is in or is approaching financial difficulty, SIPC is to be notified immediately.

If SIPC determines that any member has failed or is in danger of failing to meet its obligations to customers and that there exists one or more of the conditions specified below, SIPC, upon notice to the member, may apply to an appropriate federal district court for a decree adjudicating that the customers of the member are in need of the protection provided by the Act. The court shall grant the application and issue a decree if it finds that the member—

- a. is insolvent within the meaning of Section 1(19) ' of the Bankruptcy Act, or is unable to meet its obligations as they mature, or
- b. has committed an act of bankruptcy within the meaning of Section 3 of the Bankruptcy Act,² or
- c. is the subject of a proceeding pending in any

[&]quot;"(19) A person shall be deemed insolvent within the provisions of this Act whenever the aggregate of his property, exclusive of any property which he may have conveyed, transferred, concealed, removed, or permitted to be concealed or removed, with intent to defraud, hinder, or delay his creditors, shall not at a fair valuation be sufficient in amount to pay his debts;"

² "§3. Acts of Bankruptcy. a. Acts of bankruptcy by a person shall consist of his having (1) concealed, removed, or permitted to be concealed or removed any part of his property, with intent to hinder, delay, or defraud his creditors or any of them, or made or suffered a transfer of any of his property, fraudulent under the provisions of section 67 or 70 of this Act; or (2) made or suffered a preferential transfer as defined in subdivision a of section 60 of this Act; or (3) suffered or permitted, while insolvent, any creditor to obtain a lien upon any of his property through legal proceedings or distraint and not having vacated or discharged such lien within thirty days from the date thereof or at least five days before the date set for any sale or other disposition of such property; or (4) made a general assignment for the benefit of his creditors; or (5) while insolvent or unable to pay his debts as they mature, procured, permitted, or suffered voluntarily or involuntarily the appointment of a receiver or trustee to take charge of his property; or (6) admitted in writing his inability to pay his debts and his willingness to be adjudged a bankrupt.

court or before any agency of the United States or any state in which a receiver, trustee, or liquidator for such member has been appointed, or

- d. is not in compliance with applicable requirements under the 1934 Act or rules or regulations of the Commission or any self-regulatory organization with respect to financial responsibility or hypothecation of customers' securities, or
- e. is unable to make such computations as may be necessary to establish compliance with such financial responsibility or hypothecation rules or regulations.

Members of SIPC file financial and operating statements and reports with the Commission or one or more of the self-regulatory agencies, and the firms are inspected or examined by the personnel of these agencies. SIPC does not, and it was intended that it should not, become involved in activities which duplicate or become pyramided upon the existing reporting and inspection machinery. Accordingly, SIPC considers information supplied by the staff of the Commission or one of the self-regulatory agencies, or both, as well as pertinent information from any other sources bearing on the question of whether a firm is in or is approaching financial difficulty. SIPC's principal concern in most instances is with the question of the probable ability of a firm, even if in financial difficulty, to meet its obligations to public customers. At all times between receipt of a notice that a firm is in or approaching financial difficulty, until the firm recovers or is otherwise dealt with, the principal judgment to be made by SIPC has to do with the threat of danger to customers and their need for the protections of the Act. In every case one or more of the five conditions above specified must exist as a prerequisite to filing an application for the appointment of a trustee.

Except during the months immediately following passage of the Act, SIPC has endeavored to file its applications concurrently with the Commission's application for an injunction and the appointment of a receiver. In most cases it has been possible to so coordinate the activities of the two staffs that the applications have been filed at the same time. This, of course, tends to minimize the confusion and delay which might otherwise occur. Typically, these actions by the Commission have been based on alleged violations of the net capital rules or the absence of or such inadequacy of books and records that the firm is unable to make such computations as may be necessary to establish compliance with the rules concerning financial responsibility or hypothecation of customers' securities. In most cases SIPC expects to rely upon the Commission to establish one or more of the five statutory conditions mentioned above. To date there have been three instances where SIPC has applied for the appointment of a trustee on the basis of the information supplied by the Commission and the self-regulatory organization where no court action was sought by the Commission. In a few cases SIPC has delayed filing its application for a period after the issuance of an injunction or restraining order and the appointment of a receiver on application by the Commission until there appeared to be no reasonable doubt that customers would need the protection of the Act even though the Commission was prepared to go forward at an earlier date with its own action pursuant to its own enforcement policies. This situation could arise in at least four ways.

- 1. A violation of the net capital rule might not portend as serious a situation from the point of view of customer protection as originally feared. This rule basically is a test of liquidity as of a particular time. It does not necessarily follow that a temporary or possibly inadvertent failure to comply with a required condition of liquidity at the particular time at which a computation is made makes losses to customers inevitable.
- 2. On some occasions additional capital is invested in the firm or it is determined that adjustments can be made correcting the capital deficiency.
- 3. In some cases it develops that the firm has no public customers.
- 4. In some situations a firm will propose as an alternative to a SIPC liquidation that it will self-liquidate or will liquidate under the supervision of one of the self-regulatory organizations without loss to customers.

If in fact there is no real danger to customers, SIPC should not seek an adjudication and the appointment of a trustee. This is so because SIPC can only liquidate; it may not reorganize or furnish funds for the rehabilitation of a firm. Once a liquidation proceeding has begun it is unlikely that the process can be stopped or reversed without the rights of others having been prejudiced. Accordingly, it is important that SIPC not enter a case unless it is clear that protection of customers requires it.

The system of relying upon a flow of information from the field offices of the National Association of Securities Dealers, Inc., the Commission and the examiners of the exchanges, through the central offices of these organizations to SIPC, at times has produced delays. These arise partly because of the number of people involved, the geographic dispersion of the industry, problems of communication caused by the need to coordinate the work of two or more agencies, and the frequent inability to secure up-to-date and reliable information because of the inadequacies of records or the ignorance or uncooperative attitudes of principals. Delays of this character have been reduced as procedures have been developed and improved and staff personnel have become more familiar with the Act.

A principal problem in many cases arises from the fact that the broker-dealer has failed to establish and maintain on a current basis adequate and reliable records. In some instances it has been necessary to attempt to reconstruct records or rely upon the investigatory efforts of a receiver in order to determine the situation as to customers. In a few cases the courts have appointed temporary receivers or fiscal agents for the purpose of determining the status of a firm. The various officers and personnel of the Commission and the self-regulatory organizations consistently have demonstrated a desire to furnish all the help and assistance their resources permit and the efforts of all concerned are to be commended.

Certain other characteristics of the regulatory structure should be mentioned since they bear upon the judgments which must be made in developing an appropriate form of organization and effective and uniform procedures.

SIPC has no control over who or what firms enter the securities business and thus become "members" of SIPC or continue as such.

As indicated above, SIPC has no regulatory authority of the character conferred upon the National Association of Securities Dealers, Inc., the Securities and Exchange Commission and the securities exchanges by the federal securities acts. As will be explained, however, SIPC has an advisory role to perform in this area and has increasingly expressed a point of view on various proposals affecting the industry as experience has been gained with liquidation problems and the causes of failures.

The statute confers no subpoena power on SIPC and does not provide specific authority to conduct investigations.³ It has become clear, however, that the review of claims, the search for assets, the ascertainment of preferences, the revelation of misconduct, and the determination of whether to sue the principals of firms or others, require the development of a skilled investigative staff and the exercise of at least informal investigative procedures to supplement the more formal activities and procedures of the Commission and the self-regulatory authorities and the procedures of the trustees. In other words, although SIPC attempts to carry out its statutory obligations to pay customers' claims promptly, SIPC also has an obligation to take all reasonable steps to prevent the disbursal of its funds in payment of false, fraudulent or erroneous claims, or those barred by the Act (all of which have been encountered to date).

SIPC again wishes to acknowledge and express its appreciation for the continuing cooperation, assistance and support of the officials and staffs of the various agencies and self-regulatory organizations without which SIPC could not function. Finally, SIPC wishes to acknowledge the work and cooperation of the growing number of trustees and their counsel and accountants who have assumed the primary burden in a new and difficult field.

³ The trustee, of course, has available the processes of the court under the Bankruptcy Act.

THE CORPORATION

SIPC is a nonprofit membership corporation subject to the District of Columbia Nonprofit Corporation Act, except where inconsistent with some provision of the 1970 Act.⁴ It is to exist until dissolved by Act of Congress and, except for taxation on real property and on certain tangible personal property, is exempt from any taxation by federal or local taxing authorities.

Members

The membership of SIPC is composed of all persons registered as brokers or dealers under Section 15(b) of the Securities Exchange Act of 1934 and all persons who are members of a national securities exchange other than persons in certain excluded categories. These categories ⁵ include persons whose broker-dealer business consists exclusively of:

- a. the distribution of shares of registered openend investment companies or unit investment trusts,
- b. the sale of variable annuities,
- c. the business of insurance, or
- the business of rendering investment advisory services to one or more registered investment companies or insurance company separate accounts.

As of December 31, 1972 there were approximately 3,750 members of SIPC and approximately 1,200 persons claiming exclusion from membership. The following table reflects the number of members at the end of the year, as well as changes during the year, and their affiliation for purposes of collection of SIPC assessments.

	Nu	mber of SIPC	Members 4
Agent for Collection of SIPC Assessments	Added 7	Terminated 7	December 31, 1972
National Association of Securities Dealers, Inc. New York Stock Exchange, Inc SIPC (Securities and Ex-	322 . 35	454 75	2,349 715
change Commission only) *	135	122	281
American Stock Exchange, Inc PBW Stock Exchange, Inc.	27 21	35 9	171 90
National Stock Exchange	2	5	81
Midwest Stock Exchange, Inc. Boston Stock Exchange	1	3 1	35 15
Spokane Stock Exchange	1	2	10
Intermountain Stock Exchange Detroit Stock Exchange	e —	2	4 3
Pacific Coast Stock Exchange	1	1	2
	549	709	3,7 56 °

During the Congressional hearings and debates preceding the passage of the 1970 Act, considerable attention was given to the desirability of including in the statute standards or requirements which securities broker-dealers would have to meet in order to become members of SIPC, and indeed, the Senate bill was amended to include standards. This amendment was discussed in the conference committee but was not included in the final bill. The bill, as passed by the Congress and signed by the President, contains no eligibility requirements or standards for membership in SIPC.

The following statement by Hamer H. Budge, then Chairman of the Commission, during the hearings before the Subcommittee on Commerce and Finance of the House Committee on Interstate and Foreign Commerce is indicative of the Congressional rationale for not imposing any standards or conditions for membership in SIPC:

"It is my understanding that at the time of the establishment of the Federal Deposit Insurance Corporation that some banks and savings and loans were not permitted to become members because of their financial condition at that time. It is our feeling in this bill that it is necessary to insure the entire community, and we would not feel that it was in the public interest to remove the firms which might be in the same category as those banks and savings and loan that were not permitted to become members at the time."

"The purpose of the legislation is to protect the customers of the brokerage houses, and if we take out the funds (sic) where the greatest exposure is we are removing the protection of all the customers of those firms. It isn't easy to determine the financial condition of a brokerage house as it is a bank and savings and loan. The financial condition can change radically very quickly, much more so than a bank or savings and loan." ¹⁰

The legislative history of the 1970 Act is replete with statements of legislators and witnesses as to the desirability of upgrading the financial responsibility of broker-dealers. The Committee of Confer-

¹⁰ House Report No. 91-67, pp. 367-68.

⁴ Section 3(a).

⁵ Section 3(a)(2).

⁶ Members shown in one category in the table may, in fact, also be members of one or more of the other organizations.

[&]quot;"Added" and "Terminated" includes some duplications as firms changed memberships in organizations. Firms that merged into others are included in "Terminations."

^a These firms are not members of the National Association of Securities Dealers, Inc. or any exchange.

^{&#}x27;In minor respects these totals do not reconcile with the total of 3,994 members as of December 31, 1971 shown in SIPC's first annual report due to certain duplications and errors in the underlying membership records.

ence thought that such upgrading could best be accomplished by granting the Commission increased authority. Section 7(d) of the 1970 Act, which amends Section 15(c)(3) of the 1934 Act, and Section 9(f) were intended to achieve this objective.

The conclusion that all broker-dealer firms (other than the excluded classes) should be members of SIPC and therefore that their customers should receive the protections of the Act undoubtedly was necessitated by the exigencies of the situation in 1970. The passage of time, improvement in the financial condition of the industry, various changes in the rules, regulations and regulatory structure and other factors have contributed to a substantial change in climate, at present marked by an absence of a sense of crisis or emergency. This change of climate should not in any way cause any diminution of effort on the part of all concerned to continue the progress required by the Congress in the upgrading of the financial responsibility and qualifications of the industry.

On the other hand, SIPC's experience since the passage of the Act and the continued ease of entry into a registered status under the 1934 Act carrying with it, as it does, automatic coverage under the SIPC program raises a question as to the continued validity of the original thought that there must be coverage of the entire community. The SIPC Board has concluded that serious thought should be given to the policy implications and the range of problems which would attend a determination that SIPC coverage should be withheld upon the existence or occurrence of various conditions and circumstances and in accordance with appropriate procedures. The matter of providing, subject to the proper protection of existing customers, for the termination of SIPC membership under appropriate conditions should also receive consideration.

A considerable degree of control over the extent of SIPC coverage, in effect, could be exercised by establishing standards of qualifications and eligibility, compliance with which should be a prerequisite for the right of a registered broker-dealer to carry customers' cash and securities. It is believed that there is authority in the 1934 Act which could be invoked for rules of this character." If it should be determined that such authority is inadequate or lacking, then the policy implications of appropriate legislative changes to accomplish some measure of control over SIPC coverage should be reviewed.

The SIPC Board is strongly of the view that SIPC was not created and the SIPC fund (and possibly public funds) should not be employed to underwrite the activities of securities firms regardless of lack of competence, integrity, experience or ability to operate a business in an industry so heavily concerned with the public interest.

Section 3(f)(1) of the Act provides that any person who is a broker or dealer or member of a national securities exchange and who is excluded from membership in SIPC under Section 3(a)(2)may become a member of SIPC under such conditions and upon such terms as SIPC shall require. Section 3(f)(2) of the Act provides that any person who becomes a member of SIPC under Section 3(f)(1) shall be subject to such assessments as SIPC determines to be equitable. No action has been taken under this Section.

Broker-dealer firms which are excluded from membership under the Act are required to file, annually, a notification of that fact with SIPC, indicating the basis for exclusion. If the facts with respect to the character of business change, a written notice to this effect is required by SIPC.

Directors

Section 3(c) of the Act provides for a board of seven directors to determine the policies and govern the operations of SIPC. One director is appointed by the Secretary of the Treasury and one by the Federal Reserve Board. Five directors are appointed by the President of the United States, by and with the advice and consent of the Senate, as follows:

- a. three from persons associated with and representative of different aspects of the securities industry, not all of whom shall be from the same geographical area,
- b. two from the general public who are not asciated with any broker or dealer or a national securities exchange or other securities industry group and have not had any such association during the two years preceding appointment.

The Act further provides that the President shall designate the Chairman and Vice Chairman from those persons listed in (b) above. Directors are to be appointed for a term of three years except that, of the directors first appointed:

a. Two shall hold office for a term expiring December 31, 1971;

¹¹ See Section 15(b)(8) and Section 15A(b)(5). There would seem to be advantages to be gained from exploring fully and exhausting the rule making potential under these sections to establish, subject to appropriate procedures, demonstrable capabilities to keep and maintain records, to comply with rules, to operate a business at a profit or to comply with other requirements as a condition to engaging in certain types of activities which subject customer funds and securities to different types of risks. Experience thus gained should be valuable to regulators and the Congress should it later appear that additional legislation is, in fact, necessary or desirable.

- b. Two shall hold office for a term expiring December 31, 1972;
- c. Three shall hold office for a term expiring December 31, 1973;

as designated by the President. A director may serve after the expiration of his term until his successor has taken office.

Persons who have served as directors and those now in office are identified on page iv. For compensation of directors see page 38.

Corporate Powers

Section 3(b) of the 1970 Act gives SIPC the usual and customary general corporate powers which were specified in detail in SIPC's first annual report.

These general corporate powers are in addition to the specific grants of authority or statutory directives relative to the funding and liquidation functions and those relative to the self-regulatory organizations and SIPC's membership.

SIPC is directed to establish a fund, collect assessments, and borrow monies, if necessary (Sections 4 and 8); to apply for the appointment of trustees and to assist in the liquidation of debtor firms (Sections 5 and 6); to consult and cooperate with selfregulatory organizations with respect to inspections and reports concerning SIPC member firms (Section 9); and to prescribe the means by which members of SIPC may advertise the protection afforded customers and their accounts under the Act (Section 11).

The statute authorizes oversight of many of SIPC's activities by the Securities and Exchange Commission and, in some situations, the role of the Commission is controlling. To the extent that SIPC elects or is required to proceed by rule or bylaw, these must be filed with the Commission. Each bylaw or rule takes effect upon the 30th day after filing a copy with the Commission, or such earlier date as the Commission may determine, unless the Commission disapproves the same as being contrary to the public interest or contrary to the 1970 Act. Thereafter any change in, supplement to, or repeal of an existing bylaw likewise must be filed with the Commission. Further, the Commission may, by its rules and regulations, require the adoption, amend-

ment, alteration of, supplement to, or rescission of any bylaw or rule by SIPC, whenever adopted.

In the event of the refusal of SIPC to commit its funds or otherwise to act for the protection of customers of any member of SIPC, the Commission may apply to the district court of the United States in which the principal office of SIPC is located for an order requiring SIPC to discharge its obligations under the Act and for such other relief as the court may deem appropriate to carry out the purposes of the Act.

The Commission may make examinations and inspections of SIPC and require SIPC to furnish it with reports and records. The Act requires, in addition, that promptly after the close of each fiscal year SIPC shall submit a written report relative to the conduct of its business and the exercise of its functions during the fiscal year. These reports are required to include financial statements examined by independent public accountants selected by SIPC with the approval of the Commission. The financial statements must be accompanied by the report thereon of the accountant. The Commission, in turn, is required to transmit such report to the President and the Congress, with such comment thereon as the Commission deems appropriate.

SIPC's bylaws and rules are available for public inspection.

Although it was recognized that under Section 3 of the Act the procedures for adopting bylaws and rules would be identical, SIPC determined as a matter of policy that bylaws would be employed to set forth standards for the conduct of its internal operations, and that rules would be used to set forth matters of more general interest, including the exercise of rights and powers granted by the Act.

Section 11(a) of the Act provides that "nothing herein shall act to deny documents or information to the Congress of the United States or the committees of either House having jurisdiction over financial institutions, securities regulation, or related matters under the rules of each body. Nor shall the Commission be denied any document or information which the Commission, in its judgment, needs."

Interim reports of SIPC's activities were distributed during May 1971, at the end of June 1971, and for the quarters ending June 30 and September 30, 1972. As provided in the Act,¹² the SIPC fund at any time consists of the aggregate of cash on hand or on deposit, amounts invested in United States Government or agency securities, and confirmed lines of credit.

There are eight sources of monies for the SIPC fund. First, the principal support is received from the industry in the form of assessments based on the revenues of SIPC members. Second, the statute provides that there may be contributed and transferred to SIPC any funds held by any trust established by a self-regulatory organization prior to January 1, 1970. SIPC's first funds were received on February 23, 1971 when a check for \$3 million, from the trust fund of the American Stock Exchange was presented to SIPC by the President and Chairman of the Board of Governors of that exchange. Third, SIPC may borrow from banks or other financial institutions pursuant to lines of credit or other written agreements which provide that monies borrowed are to be repayable not less than one year from the time of borrowing. Fourth, SIPC receives income on its investments, an increasingly material item. Fifth, SIPC is entitled to be repaid advances made to trustees for the completion of open contractual commitments and to recoup administrative expenses from the single and separate fund in priority to claims of customers against such fund. Sixth, SIPC may be able to recover funds from the single and separate fund, the general estate, the principals of failing firms or from others on claims of customers to which SIPC becomes subrogated as provided in the Act. Seventh, in connection with the settlement of administrative disciplinary proceedings of the Commission, the parties may stipulate as part of the settlement that the respondent brokerdealer firm will pay a sum of money to SIPC or to a charity if SIPC is unable or unwilling to accept the gift. The SIPC Board indicated its willingness for SIPC to accept such gifts subject to the proviso that SIPC had no connection with the proceeding and that there were no conditions of any character to such payment. Finally, in the event of the inadequacy of the SIPC fund, which presumably would result only from a crisis of great severity and magnitude, SIPC may borrow from the Commission which, in turn, may borrow from the Secretary of the Treasury amounts up to \$1 billion.

Assessments

The Act provides authority for SIPC by bylaw or rule, to impose a General Assessment upon each of its members at a rate of not less than $\frac{1}{2}$ of 1 per centum of the gross revenues from the securities business ¹³ of such member. This general authority is subject to several qualifications.

A general assessment may be made at a rate in excess of $\frac{1}{2}$ of 1 per centum during any twelve month period if SIPC determines, in accordance with a bylaw or rule, that such rate will not have a material adverse effect on the financial condition of its members or their customers. No such assessment may be made, however, upon a member which would require payments in excess of 1 per centum of the member's gross revenues from the securities business for the period.

The Act contemplates that this $\frac{1}{2}$ of 1 per centum rate shall be imposed (a) until the balance of the fund aggregates not less than \$150 million or such other amount as the Commission may determine in the public interest, (b) during any period when there is any outstanding borrowing, and (c) whenever the balance of the fund (exclusive of confirmed lines of credit) is below \$100 million or such other amount as the Commission may determine.

During any period in which (a) the fund (exclusive of confirmed lines of credit) aggregates less than \$150 million or such other amount as the Commission may determine or (b) SIPC is required under Section 4(d)(2)(B) to phase out of the fund all confirmed lines of credit, the aggregate assessments payable by SIPC members shall not be less than $\frac{1}{4}$ of 1 per centum per annum.

According to SIPC's bylaws, assessments may be paid quarterly on the basis of estimates of gross revenues for each quarter (not less than one quarter of the assessments payable for the preceding year) or on the basis of actual gross revenues for each quarter. Not later than 120 days after the close of each calendar year, SIPC member firms are required to file a reconciliation of revenues reported to SIPC with revenues reported on Form X-17A-10 and pay

 $^{^{\}rm 13}$ Gross revenues from the securities business are defined in Section 4(i) of the Act and the instructions to the assessment forms.

The assessment forms are based on the Commission's Form X-17A-10 which prescribes the income and expenses and related financial and other information which must be filed by members of a national securities exchange and every broker or dealer registered under the 1934 Act not later than 120 days after the close of each calendar year.

¹² Section 4(a).

any additional assessments due on the income from the prior calendar year. Any overpayments may be credited against future assessments payable.

The agreement for the existing line of credit was entered into on April 14, 1971 and provided for a maximum availability of \$65 million. The agreement provided that the balance of the available unused credit would be reduced by \$10 million on April 1, 1972 and by an equal amount on April 1 of the next succeeding four years, with a final balance of \$15 million expiring on October 13, 1976, assuming no borrowing under the agreement. Accordingly, the SIPC fund was reduced by \$10 million in April 1972. The line of credit was further reduced to \$45 million on April 1, 1973.

The Act provides that after December 31, 1973 confirmed lines of credit shall not constitute more than \$50 million of the fund and that when the balance of the fund aggregates \$150 million (or such other amount as the Commission may determine) SIPC shall phase out of the fund all confirmed lines of credit.

In connection with the Credit Agreement, SIPC agreed to maintain with the participating banks compensating demand deposits equal to ten percent of the banks' respective commitments. The Credit Agreement requires that SIPC pay, quarterly, a commitment fee of $\frac{1}{2}$ of 1 percent per annum based on the unused commitment.14 On any borrowing under the Credit Agreement SIPC is required, among other things, to pay, quarterly, interest at a rate which is equal to 1 percent per annum greater than the prime rate charged by the agent ¹⁵ for the participating banks on ninety day loans to substantial and responsible borrowers. An additional 1 percent is payable on all principal amounts not paid when due. Coincident with any borrowing under the Credit Agreement, SIPC is required to pledge assessments received or receivable during the period that any portion of the borrowing is unpaid except that such pledge is limited, during the period that any borrowing by SIPC from the Commission under Section 4(g) of the Act is outstanding to payments of $\frac{1}{4}$ of 1 percent of members' SIPC gross revenues for any twelve month period. There have been no borrowings by SIPC under the credit agreement or otherwise.

On December 31, 1972 the SIPC Fund totaled approximately \$105 million and was composed of the following categories:

Cash (includes compensating balances) U.S. Government obligations	\$ 5,520,000
at amortized cost and accrued interest Confirmed line of credit	44,458,000 55,000,000
	\$104,978,000

without giving effect to estimated assessments for the fourth quarter and adjustments based on 1972 revenues to be received after the year end, aggregating \$7,310,000.

Designations of self-regulatory organizations as examining authorities solely for the purpose of acting as SIPC's collection agents were made as follows:

- 1. The New York Stock Exchange to serve as examining authority for the purpose of acting as collecting agent for each of its members.
- 2. The American Stock Exchange to serve as examining authority for the purpose of acting as a collecting agent for each of its members who is not also a member of the New York Stock Exchange.
- 3. The National Association of Securities Dealers, Inc. to act as examining authority for the purpose of acting as collecting agent for each of its members who is not also a member of either the New York Stock Exchange or American Stock Exchange.
- 4. The registered national securities exchange (other than the New York Stock Exchange or the American Stock Exchange) of which a member of SIPC is a member to serve as examining authority for the purpose of acting as collecting agent for each of its members who is not also a member of the National Association of Securities Dealers, Inc.

SIPC members who are not members of any selfregulatory organization mail their assessments directly to a bank depository for the account of SIPC.

Each SIPC member firm now pays a general assessment at a rate of $\frac{1}{2}$ of 1 per centum per annum of its gross revenues from the securities business. Assessments will continue at not less than this rate until the balance of the fund aggregates not less than \$150 million or such other amount as the Securities and Exchange Commission may determine.

¹⁴ SIPC accepted the provision for maintaining compensating balances and a commitment fee of $\frac{1}{2}$ of 1 per centum per annum rather than pay the 1 percent per annum fee which otherwise would have been required by the banks. This decision reflected a recognition that SIPC's investments in the early years should be maintained in relatively short term maturities. At rates of return of less than 5 percent on these investments it would be to SIPC's advantage to pay the lower fee. It should be noted that the compensating balances are available for SIPC's use at all times if needed. With the expiration of \$10 million of the line of credit on April 1, 1972, and an additional \$10 million on April 1, 1973, the compensating deposits were reduced by \$1 million on each of these dates, which amounts thereupon were invested in United States Government securities.

¹⁵ The Chase Manhattan National Bank National Association acts as agent for the participating banks under the Credit Agreement.

A uniform rate of assessment, of course, results in some members of the industry bearing what they consider to be a disproportionate and discriminatory burden of the costs of SIPC. Many SIPC member firms, including for example some of the trading houses and the exchange specialists, do no business directly with public customers, yet assessments are imposed upon them by the Act at the same rate paid by the firms doing a substantial retail business.

Inquiries from members continue to indicate some lack of understanding that the rate of $\frac{1}{2}$ of 1 percent is prescribed by the Act and that the decision by Congress to impose assessments at a minimum rate during the early years of SIPC was a deliberate one. This policy decision stemmed in part from a desire to build up the fund rapidly from industry sources and thus minimize the risk that government borrowing might be necessary. There was an intention, also, to spread the cost of the program, which is designed to contribute to public confidence in the securities markets, over a broad spectrum of the industry since the entire industry benefits from the attainment of these objectives.

After the fund has reached the desired level, SIPC is expected, as indicated in Section 4(c)(2) of the Act, to vary assessments as between classes of members. Thus as to any one or more classes of members, assessments may be based in whole or in part on, or measured by, the amount of gross revenues from the securities business, or all or any of the following factors: the amount or composition of gross revenues from the securities business, the number or dollar volume of transactions effected, the number of customer accounts maintained or the amounts of cash and securities in such accounts, their net capital, the nature of their activities (whether in the securities business or otherwise) and the consequent risks, or other relevant factors.

It is not possible at this time to indicate the probable time at which SIPC can undertake to vary assessments as between classes of members on the basis of allocations of risks, costs, or other factors.

Much will depend upon the time required to build the fund to the prescribed \$150 million. This, in turn, will be affected by the future financial health of the industry, the volume of assessments received, the volume of liquidations of SIPC member firms, and the demands upon the SIPC fund for advances to trustees for the benefit of customers and administration and other costs, the need for and the amount of any borrowing, and finally the rapidity of the phaseout of confirmed lines of credit.

Although it is not possible to project with any certainty when varying rates could be instituted, it is not too soon to begin the work of assembling and preparing the basic data required to support the decisions ultimately to be made on this subject.

Accordingly, in October an invitation was sent to the self-regulatory organizations and the Commission to designate persons who might be asked to serve on a task force which would study the many aspects of this complicated project. Essentially, SIPC proposed the formation of a joint committee for the purpose of considering the problems which will be encountered in the definition, collection and processing of data essential to support or assist in reaching the eventual decisions as to variable rates. It was thought desirable to constitute a committee which would include economists, persons familiar with all phases of broker-dealer operations in all the varied lines of business in which members of the industry engage, as well as persons familiar with data processing techniques.

The response to our invitation was excellent and it is anticipated that in the near future selected personnel will be invited to meet with the SIPC staff to begin the development of a program.

Assessment revenues received and accrued for the periods since inception (December 30, 1970) through December 31, 1972 aggregate \$62,110,425. Assessment revenues classified by principal collection agents follow:

SIPC collection agents to whom	Assessments (See notes)			
assessments are paid 16	1971(1)	1972(2)	Total	
NYSE ASE NASD All other exchanges	\$25,257,961 488,374 3,790,129	\$27,725,356 487,568 3,780,945	\$52,983,317 975,942 7,571,074	
(seven) SIPC	104,497 137,308 \$29,778,269	55,092 283,195 \$32,332,156	159,589 420,503 \$62,110,425	

Notes:

- 1. Includes \$5,669,180 initial assessments (based on 1969 gross revenues).
- 2. Includes \$4,143,321 of 1971 revenues received in 1972 in excess of the December 31, 1971 accrual.

The revenues above do not purport to reflect the volume of business conducted on the respective exchanges or in the over-the-counter market. The assessments are collected through the collection agents without regard to the sources of revenues on which the assessments are based.

¹⁶ Details regarding designations of SIPC collection agents —page 11.

The quarterly general assessment revenues averaged \$7 million for 1971 and 1972. The options available to prepay or pay quarterly assessments on an estimated basis (based upon the preceding year's assessment) and the effect of fluctuations in receipts from members paying assessments based on actual gross revenue make a quarterly presentation of assessment revenues difficult and not particularly meaningful.

As of September 1, 1972, based on data reported by SIPC collection agents, approximately 1,500 brokers or dealers had failed to file certain assessment forms, or claims for exclusion from membership, or had failed to pay the related assessment installments. Notifications in which the apparent deficiencies were enumerated were mailed by SIPC to each of these broker-dealers and a ten day period was prescribed during which corrective action was required. In this connection, the provisions of Section 10(a) of the Act " were quoted for the attention of the recipient. The responses to this program were:

	Number of brokers or dealers who				
Agent for Collection of SIPC Assessments	Were mailed notifications	Eliminated deficiencies	Did not respond	Had withdrawn registration	Could not be located
NASD	1,124	579	154	376	15
SIPC	183	23	50	110	
NSE	53	3	33	16	1
NYSE	48	15	1	32	_
ASE	44	35	8	1	
PBWSE	31 18	7	13	10	1
BSE	10	9		1	_
MSE	7		5	2	
ISE	6	_	4	2	
SSE	5	5	_		
DSE	2	2		—	
PCE	1	1			—
	1,514	679	268	550	17

¹⁷ Section 10(a) is quoted in full:

SEC. 10. PROHIBITED ACTS

(a) FAILURE TO PAY ASSESSMENT, ETC.—If a member of SIPC shall fail to file any report or information required pursuant to this Act, or shall fail to pay when due all or any part of an assessment made upon such member pursuant to this Act, and such failure shall not have been cured, by the filing of such report or information or by the making of such payment, together with interest thereon, within five days after receipt by such member of written notice of such failure given by or on behalf of SIPC, it shall be unlawful for such member, unless specifically authorized by the Commission, to engage in business as a broker or dealer. If such member denies that he owes all or any part of the amount specified in such notice, he may after payment of the full amount so specified commence an action against SIPC in the appropriate United States district court to recover the amount he denies owing.

¹⁸ Notifications were not mailed to an additional 43 delinquent members who were Canadian broker-dealers because PBWSE represented that it was actively pursuing these members as a result of which it expected the deficiencies would be eliminated. Through March 31, 1973 \$150,000 of delinquent assessements were collected as a result of this program.

During July and August SIPC's independent public accountants were engaged to review the procedures used by SIPC's principal collection agents and to select, at random, member filings for comparison with the applicable form X-17A-10 data. Recommendations resulting from this engagement included: (a) revised collection agent procedures, which require among other things: (1) the prompt reporting to SIPC, and follow up, of delinquencies, and (2) comparison of filings with applicable Form X-17A-10 data, an interim procedure intended to reveal errors in assessment payments, as well as invalid claims for exclusion from SIPC membership, pending the effectiveness, on a current basis, of SEC Rule 17a5(b)(4) (see page 14).

On December 29, 1972, notices pursuant to Section 10(a) of the Act were mailed to 57 members who had failed to respond to prior notifications of apparent deficiencies. These notices resulted in payment of approximately \$2,600 in delinquent assessments and filing of forms to eliminate the deficiencies by fourteen members. The others so notified consist of: (1) twenty-six Canadian firms that are or were members of the PBW Stock Exchange, Inc. and have, together with the Montreal Exchange, engaged Counsel to discuss with SIPC and the Commission the applicability to them of the SIPC filing and assessment requirements, and (2) seventeen other registered brokers or dealers who had not responded to prior SIPC notices (These brokers have been notified by the SEC that they must cease doing business as a broker or dealer unless otherwise authorized by the Commission).

During April 1973 the deficiency notification program will be repeated for all delinquent members including those persons becoming registered under the 1934 Act after August, 1972 and Section 10(a) notices will be mailed to those not correcting the deficiencies on a timely basis; as required by the Act. Thereafter, because of the revised SIPC Collection Agent procedures regarding delinquents, SIPC anticipates only a minimum delinquency problem. Effective January 1, 1973 interest will be owing on delinquent payments pursuant to a new bylaw (see page 15). If a member of SIPC fails to pay within fifteen days of due date any portion of an assessment, interest must be paid thereon at the rate of 8% per annum. If any broker or dealer has incorrectly filed a claim for exclusion from membership, such broker or dealer must pay, in addition to the assessment due, interest at the rate of 8% as described above. Interest is computed from the later of the due date or January 1, 1973.

On October 15, 1972 the Commission's Rule 17a-5(b)(4) became effective. This rule requires that a supplemental report on SIPC membership status accompany the broker-dealers' annual reports of financial condition filed pursuant to Form X-17A-5. In addition, this supplemental report must be accompanied by a certification by the independent public accountant who certifies the reports of financial condition to the effect that the SIPC assessment payments were fairly determined in accordance with applicable instructions. One copy of the supplemental report and the certification thereof is forwarded to SIPC by the Commission's regional office with which it is filed. A review procedure is being established which will include comparison of the details of the supplemental reports received by SIPC with its filing and payment history records, as well as review of the report for substantial conformity with Rule 17a5(b)(4). Since the full effectiveness of the Rule cannot be realized until 1974, SIPC Collection Agents' procedures were revised to include the interim review procedures described above (see page 13).

Borrowing Authority Other Than From Commercial Sources

In the event that the fund is or may reasonably appear to be insufficient for the purposes of the Act, the Commission is authorized to make loans to SIPC. With the application for, and as a condition to such loan, SIPC must file with the Commission a statement respecting the anticipated use of the loan proceeds. If the Commission determines that such loan is necessary for the protection of customers of brokers or dealers and the maintenance of confidence in the United States securities markets, and that SIPC has submitted a plan which provides, under the circumstances, a reasonably feasible assurance of prompt repayment, then the Commission shall so certify to the Secretary of the Treasury and issue notes or other obligations to the Secretary of the Treasury in an aggregate amount not to exceed \$1 billion. If the Commission determines that the amount of, or time for, payment of the assessments pursuant to such plan would not satisfactorily provide for the repayment of such loan, it may, by rules and regulations, impose upon the purchasers of equity securities in transactions on national securities exchanges and in over-the-counter markets, a transaction fee in such amount as at any time or from time to time it may determine to be appropriate, but not exceeding one-fiftieth of 1 percent of the purchase price of the securities. No such fee shall be imposed on a transaction (as defined by rules or regulations of the Commission) of less than \$5,000. The term "purchasers" does not include a broker or dealer registered under Section 15(b) of the 1934 Act or a member of a national securities exchange unless such purchase is for an investment account of such broker, dealer or member. The Commission may, by rules and regulations, exempt any transaction in the over-the-counter markets in order that assessment of fees on purchasers in those markets be on a basis comparable to the assessment of fees on purchasers in transactions on national securities exchanges. Such fees are to be collected by the broker or dealer effecting the transaction for or with the purchaser and are to be paid to SIPC in the same manner as assessments are otherwise paid under the Act.

The Secretary of the Treasury prescribes the terms and conditions of any notes issued by the Commission for purposes of a loan to SIPC. During any period when any treasury borrowing is outstanding, no pledge of any assessment upon a member to secure any other borrowing shall exceed 1/4 of 1 percent of the member's gross revenues from the securities business for any twelve-month period.

Treatment of Prior Trusts

The transfer of the trust fund of the American Stock Exchange in the amount of \$3 million in February 1971 has been mentioned. A second such transfer occurred in December 1971, when \$11,925 was received from that fund. It is unlikely that any large amounts will be received in the future by transfers of the remainders of any trust funds which had been established by any of the other exchanges.

Consequences of Nonpayment or Underpayment of Assessments

If a member of SIPC fails to pay when due all or any part of an assessment the unpaid portion may be subject to interest charges as may be determined by bylaw or rule of SIPC. The Board was of the view that during a start-up period and until SIPC's rules and bylaws became known and understood by the industry, no attempt should be made to impose penalty charges for nonpayments or short payments.

In September the Board considered the question of providing for the imposition of penalties for nonpayment or overdue payment of assessments. The Board considered its power under the Act, specifically that set forth in Section 4(e)(3) which gives the Corporation power to impose interest on unpaid assessments as well as its power under Section 4(c)(3). The Board approved amendments to the bylaws of the Corporation which would have imposed an additional assessment for delinquent payments in the amount of ten percent of the total amount of assessment due as well as interest at the rate of eight percent per annum on the unpaid portion of any assessment which was overdue. The Commission expressed concern about the bylaw providing for the additional assessment, indicating the view that SIPC, under the law, had authority only to charge interest or put a member out of business. Accordingly, the Corporation withdrew that proposed bylaw amendment. The amendment which provided for eight percent interest on unpaid assessments became effective as of January 1, 1973, and provides as follows:

"Article 6, Section 2. (g) Interest on Assessments.

Effective January 1, 1973, if all or any part of an assessment payable under Section 4 of the Act has not been received by the collection agent within 15 days after the due date thereof, the member shall pay, in addition to the amount of the assessment, interest at the rate of 8% per annum of the unpaid portion of the assessment for each day it has been overdue. If any broker or dealer has incorrectly filed a claim for exclusion from membership in the Corporation, such broker or dealer shall pay, in addition to all assessments due, interest at the rate of 8% per annum of the unpaid assessment for each day it has not been paid since the date on which it should have been paid."

NOTICE TO SIPC THAT A FIRM IS IN OR APPROACHING FINANCIAL DIFFICULTY

Section 5(a)(1) requires the Commission or the self-regulatory organizations to notify SIPC immediately upon discovery of facts which indicate that a broker-dealer subject to regulation is "in or is approaching financial difficulty." A primary purpose of an early warning system is, of course, to afford a self-regulatory organization an opportunity to initiate procedures so that the broker-dealer in question does not become a SIPC casualty. A primary purpose of the early notification procedure is to afford SIPC ample opportunity to prepare for the selection and appointment of a trustee and supporting personnel capable of handling the problems of a particular case and to prepare to assume the financial burden which may devolve upon it to satisfy promptly claims of customers.

The statute does not define "financial difficulty." Neither has it seemed practicable, on the basis of experience to date, for SIPC to attempt to define these terms or to establish guidelines on an industry wide basis. In view of the number of self-regulatory organizations involved and the differences in their rules, procedures and problems, it has been considered appropriate up to this point at least to work with each organization separately. For example there are seven different capital rules of general application now in operation in the industry and there are differences in the manner in which the various reporting and surveillance systems operate.

Accordingly, SIPC has relied upon the judgment and experience of the examining staffs of each of the self-regulatory organizations and the Commission as to the circumstances under which a Section 5(a) notice¹⁹ shall be given. One of the difficulties encountered by all the self-regulatory organizations has been the rapidity with which a firm's financial position may deteriorate if customers fail to deliver securities, other firms fail to honor commitments, the market prices of particular securities decline sharply, or for other reasons. Frequently, the first intimation of serious trouble will be communicated to SIPC by a telephone call advising of the results of an inspection or of a report by a SIPC member to an exchange, the NASD or the Commission that a net capital, record keeping or other problem has arisen. This will set in motion a series of inquiries and the exchange of information among the staffs of the Commission, the NASD, and sometimes one or more of the exchanges and SIPC for the purpose of ascertaining the existence and magnitude of the "difficulty." Frequently a written notice to SIPC referenced to Section 5(a) will follow at a later date when the facts have been more definitely determined.

As soon as it is brought to SIPC's attention that a firm is in trouble, a file is established, information is collected from any available source, an effort is made to determine whether and to what extent there may be customer exposure, and arrangements are made for identifying possible qualified candidates in the community in which the firm operates for the position of trustee, trustee's counsel if necessary, and an accounting firm familiar with brokerage accounting.

The New York Stock Exchange has continued its practice of submitting periodically a written report to SIPC in the form of a letter from the Department of Members Firms. These reports, which in recent months have been based upon the Joint Regulatory Report,²⁰ are submitted monthly and describe the member firms which are on the Exchange's special surveillance list due to some failure or anticipated

¹⁹ These notifications and the information on which they are based are not made public by SIPC when received since to do so might make difficult, if not impossible, efforts to prevent failure of a firm. If SIPC files an application and a trustee is appointed the public file would include the notification as well as the court record.

²⁰ The Joint Regulatory Report of Broker/Dealers' Financial and Operational Condition was adopted in January, 1972 by the New York Stock Exchange and the American Stock Exchange. The report included in its schedules and instructions a comprehensive interpretative guide never before assembled in one document, which was designed to assure uniform reporting and fair and equal regulatory treatment. It eliminated duplication by replacing the former Special Financial Questionnaire, Special Operations Questionnaire, Weekly Underwriting Report, Monthly Survey of Capital and Profitability and the Monthly FACS Report. It was designed for computer review and analysis by the self-regulatory agencies to produce oversight and management feedback information and comparative data and trends for particular firms, similar groups of firms and the industry. Finally, the report was designed to permit management or the selfregulatory organizations to look in depth at various areas of interest utilizing exception reporting criteria.

failure of the member firm to comply with the Exchange's rules or criteria. The reports also indicate the actions being taken or proposed to be taken by the member or the Exchange, or both, to identify the nature and magnitude of any problem and the steps being taken to remedy it. These monthly reports are supplemented by short form weekly reports to record material events or interim changes.

The New York Stock Exchange during 1972 reported to SIPC that an aggregate of 65 firms carrying accounts and 45 firms introducing accounts ²¹ were under special surveillance at various times during the year.

In 1971 the NYSE had notified SIPC that 29 firms carrying customers' accounts and 19 firms which introduce accounts to other member organizations were at various times, on the special surveillance list.

During 1972 the Exchange adopted more stringent criteria for placing firms under special surveillance than those utilized in 1971.

Eliminating duplications, there were 77 individual carrying firms and 48 individual introducing firms reported to SIPC as being under special surveillance at various times during the two-year period. The status of these firms as of December 31, 1972 was as follows:

	Firms Carrying Accounts	Firms Introducing Accounts
Removed from list		
difficulties corrected	47	28
Merged with other firms	5	1
Became introducing firms	3	
Currently being monitored	17	12
Resigned membership, currently member of NASD only 22	_	1
Have liquidated or are in the process of self- liquidation under ex-		
change monitoring ²³	5	6

In general, the present policy of the Exchange as applied to firms carrying customer accounts requires that a firm may not expand its business if aggregate indebtedness is more than 1000 percent of net capital or if scheduled capital withdrawals during the next six months would result in a ratio in excess of 1000 percent. Further, a firm must take steps to reduce its business if the ratio exceeds 1200 percent, or if scheduled capital withdrawals during the next six months would result in a ratio in excess of 1200 percent.

Under present NYSE rules a ratio in excess of 1500 percent involves a violation of the Exchange's net capital rule (Rule 325).

The National Association of Securities Dealers, Inc, is the only organized group registered with the Commission under Section 15A of the 1934 Act. Its membership is much larger, more diversified and geographically dispersed than those of the securities exchanges. The NASD membership includes a high percentage of firms which also are members of one or more exchanges. Further, under the existing regulatory structure there has been relatively free access to the non-exchange segments of the industry and the Association, and the applicable capital rules generally have been less restrictive than those of the exchanges. Accordingly, the NASD, with several thousand members in 14 districts, has a monitoring and surveillance problem which poses its own difficulties and complexities and which has complicated the work of developing a reporting system for purposes of Section 5(a) of the 1970 Act.

As mentioned in SIPC's first annual report, effective December 31, 1970, the NASD initiated a guarterly reporting system pursuant to which certain selected financial information is reported by NASD member firms to the Association's Executive Office. These data are analyzed by a computer program which reveals data changes for the reporting firms and provides a basis for referrals of firms to the Association's field offices for inspections or other action. This program is in addition to other field inspection and surveillance programs. SIPC has been advised that the continued use by the NASD of Form Q rather than the Joint Regulatory Report has been dictated, among other reasons, by differences between the capital rule to which sole NASD members are subject and the various exchange capital rules. The Association also has informed SIPC that it uses the Joint Regulatory Report to monitor those of its members which are also members of the New York and American Stock Exchanges.

The NASD and SIPC staffs have consulted frequently on such matters as improving the content of the "Q" reports, frequency of reporting by the member firms and the development of a more effective system of reporting of events material to both the NASD and SIPC for purposes of Section 5(a).

²¹ Firms which introduce accounts on a fully disclosed basis to other New York Stock Exchange member organizations do not pose a problem for SIPC since they carry no public customers' accounts nor do they hold any assets of customers.

²² NASD reported in March 1973 the firm has not conducted a securities business since October 1972.

²³ NYSE advised SIPC in March 1973 that there are no obligations due to customers.

In a fairly common situation the Commission's headquarters office 24 receives notification from one of its regional offices or from the NASD that a firm appears to be in violation of the net capital rule. Some of these notifications indicate serious financial difficulty on the part of the firm. In other cases, however, the net capital or other violation is an isolated or temporary condition where an otherwise adequately capitalized firm suddenly finds itself in violation as a result, for example, of some abrupt market movement or a delay in closing out an underwriting or other commitment. The Commission usually has not transmitted notices in these latter cases. The usual procedure is to wait until it appears that the firm has failed to put itself quickly into compliance or will be unable to do so. A considerable number of the firms for which some form of notice has been received by SIPC from the Commission or NASD rectify their net capital situation without becoming the subject of a Section 5 notice.

For the year 1972 SIPC received 96 initial notifications of NASD member firms which were in or approaching financial difficulty. Sixty of these initial notices were received from the NASD; 35 from the SEC; ²⁵ and one from the Intermountain Stock Exchange.

For the year 1971 SIPC received 79 initial notifications of NASD member firms which were in or ap-

²⁵ It can be assumed that in many of these the SEC received their information in the first instance from the NASD.

proaching financial difficulty. Fifty-two of these initial notices were received from the NASD; 21 from the SEC; ²⁵ 4 from the PBW Stock Exchange; and 2 from the Midwest Stock Exchange.

The status of the aforementioned 175 NASD member firms, 7 of which were also members of regional securities exchanges, as of December 31, 1972, is as follows:

No longer registered as brokers or dealers		14
Out of business although currently		21
registered		31
In receivership		12
Removed from list, difficulties since		
corrected		26
Currently being monitored		28
Firm being liquidated under provisions		
of the 1970 Act:		
Trustees appointed 1971	24	
Trustees appointed 1972	40	64 26
		175
		1/J

SIPC has been advised that during the year 1972, the following securities exchanges at various times had placed certain of the member firms under special surveillance as follows:

American Stock Exchange, Inc.	8
Boston Stock Exchange	36
Midwest Stock Exchange, Inc.	78
Pacific Coast Exchange, Inc.	17
PBW Stock Exchange, Inc.	49

The SIPC staff has been conferring with representatives of the regional exchanges with reference to their reporting procedures and the flow of information concerning their special surveillance actions.

In general, a member was placed under special surveillance if net capital was deficient or the ratio of aggregate indebtedness to net capital exceeded the rules, or guidelines (which frequently were more stringent than the rules), or if the firm had operating losses in a given period which exceeded certain criteria.

²⁴ Under existing procedures the Commission's staff auto-matically notifies SIPC that a firm is in or approaching financial difficulty in either of two circumstances: (1) whenever there is a determination to recommend that the Commission file an application for an injunction against a firm for net capital or bookkeeping violations (preliminary notice is often given to SIPC prior to Commission approval of this recommendation with the full information on which to premise an application by SIPC being furnished later), and (2) whenever a firm notifies the Commission, under its Rule 17(a)-11, of bookkeeping or capital violations. SEC Rule 17a-11 requires telegraphic notice to the Commission and to each registered securities exchange or securities association of which the firm is a member when net capital is less than required by any capital rule to which the broker-dealer is subject or at any time when the firm fails to make and keep current the books and records required by SEC Rule 17a-3. The rule further requires supplemental follow-up reports on Form X-17A-11 of specific current financial and operational data related to the failure for which telegraphic notice was sent.

²⁴ Of the 64 NASD firms in liquidation, one was also a member of the Intermountain Stock Exchange and two were also members of the PBW Stock Exchange, Inc.

SIPC APPLICATION FOR COURT DECREE THAT CUSTOMERS NEED THE PROTECTION PROVIDED BY THE ACT

One purpose ²⁷ of the notice under Section 5 is, of course, to provide SIPC with the facts upon which to base its decision whether to seek the appointment of a trustee and thus initiate the liquidation of a firm in accordance with the specialized procedures of the Act.²⁸

There are five conditions ²⁹ specified in Section 5(b), at least one of which must be found by SIPC and the Court to exist in every case.

In addition, before filing an application for the appointment of a trustee SIPC must have determined that the member firm in question has failed or is in danger of failing to meet its obligations to customers.

If, within three days after the filing of an application, or such other period as the Court may order, the member shall consent to or fail to contest the application, or fail to controvert any material allegation of the application, the Court shall issue a decree adjudicating that the customers of the member are in need of protection under the Act. The statute provides that the Court then appoints, as trustee for the liquidation of the business of the member and as attorney for the trustee, such persons as SIPC specifies.³⁰ It is provided, however, that no person shall be appointed to either position if he is not "disinterested" within the meaning of Section 158 of the Bankruptcy Act.

Section 5 (b)(4) of the Act defines the term "debtor" (a term employed throughout Section 6) to mean the SIPC member firm, and the term "filing date" (a date critical to the interpretation and administration of Section 6) to mean the date on which a SIPC application is filed with the Court, except that if

- a. a petition was filed before such date by or against the debtor under the Bankruptcy Act, or
- b. the debtor is the subject of a proceeding pending in any court or before any agency of the

United States or any State in which a receiver, trustee, or liquidator for the debtor was appointed which proceeding was commenced before the date on which the SIPC application was filed,

then the term "filing date" means the date on which such petition was filed or such proceeding commenced.

The critical question in virtually all cases, and the one as to which it frequently is difficult to get solid facts as of the time a decision is required, is whether the firm has failed or is in danger of failing to meet its obligations to customers.

The Commission, in the discharge of its regulatory duties, usually will proceed promptly to seek an injunction and frequently will petition at the same time for the appointment of a receiver, when it learns that a broker-dealer is violating the net capital or record keeping rules or is engaged in other illegal conduct.

In some instances it is not possible to determine prior to the time the Commission goes to court whether there is, in fact, customer exposure. Accordingly, it sometimes occurs that a restraining order is issued and a receiver appointed prior to the time SIPC is prepared to make the determination required by the 1970 Act. In some cases, of course, it has developed that the firm had no public customers or that they had been paid amounts owing to them or that the violations which had prompted Commission action had been remedied. In these situations, SIPC would not apply for a trustee and would take no action except to complete its records in the matter.

In other cases the nature and scope of obligations to public customers is determined after the beginning of the SEC court action and it then becomes evident that SIPC protection of customers is necessary. In these cases SIPC files an application for the appointment of a trustee after the court has appointed a receiver on the petition of the Commission.

As the staffs of the NASD, the Commission and SIPC gained experience, an effort was made to reduce or eliminate the time lag between the actions of the Commission and SIPC. Increasingly, it has been possible for SIPC and the Commission to ap-

²⁷ Another and very significant effect, if not purpose, of the notice provisions is to cause the self-regulatory organizations to concentrate on types of early warning signals and to seek to detect difficulties as soon as possible.

²⁸ Section 5(a)(2) provides in pertinent part that "... SIPC, upon notice to such member, may apply to any court"
²⁹ See pages 4-5 of the "Introduction" where the five con-

ditions are stated. ³⁰ See, however, Litigation, p. 27.

pear in court at the same time, with their respective applications.

Section 5(b)(2) of the Act states that "the court to which application is made shall have exclusive jurisdiction of the debtor involved and its property wherever located with the powers, to the extent consistent with the purposes of this Act, of a court of bankruptcy and of a court in a proceeding under Chapter X of the Bankruptcy Act."

In the same section the statute states that the "court shall stay" pending proceedings to reorganize, conserve, or liquidate the debtor or its property, any other suit against any receiver, conservator or trustee of the debtor or its property. In addition, each SIPC application that is granted stays any action, other than one brought by the Securities and Exchange Commission, unless an order of the court has first been obtained.

In designating the trustee and the attorney for the trustee to conduct liquidations under the 1970 Act, SIPC has attempted to locate attorneys and accountants who have had experience in the brokerage industry and some familiarity with bankruptcy and securities laws. Generally, the trustee is an attorney. In three instances one of SIPC's employees was appointed trustee, partly in the interest of economy, and partly to gain firsthand experience with the problems encountered in a stockbroker liquidation. In a number of cases accountants have been designated trustees.

SIPC has employed a form of consent to the SIPC

application and when it is signed by the member firm it is possible for the court to make its adjudication and appoint a trustee immediately upon the filing of the application. In most cases in which the firms have not consented the court usually has directed that a hearing be held within a short period. No court has made its adjudication and appointed a trustee prior to the expiration of the three business day period prescribed in the Act in any case in which the firm has not consented.

In view of the possibility of the injection of new capital or some other corrective action during that period, earlier court action might indeed be premature. Nevertheless, SIPC considers it important in many cases to bring to an end the firm's access to its assets and books and records and it is in this connection that SIPC urges the appointment of a temporary receiver under Section 5(b)(2) to take control of assets pending adjudication.

If SIPC determines that certain conditions exist, it may in its discretion apply to the appropriate federal court for a decree adjudicating the customers of a member to be in need of the protection afforded by the 1970 Act.

If SIPC refuses to act for the protection of the customers of any of its members, the Commission has authority under Section 7(b) of the 1970 Act to apply to the federal court for the district in which SIPC's principal office is located for an order requiring SIPC to discharge its statutory obligations. No application under this section has been filed.

General Nature of a SIPC Liquidation

Section 6 of the 1970 Act sets forth the purposes of a proceeding in which a trustee has been appointed, the procedures to be followed, the powers and duties of the trustee, and the rights and priorities of the customers of the debtor firm.

The proceeding is essentially a liquidation proceeding, and the 1970 Act denominates it as such. In order to assure that only a liquidation will take place, Congress provided that, even though the proceeding is to be governed to a very large extent by those provisions of the Bankruptcy Act (11 U.S.C. § 1 et seq.) relating to corporate reorganizations (Chapter X), in no event is a plan of reorganization to be formulated.

The powers and duties of the trustee are quite broad. Section 6(b)(1) gives the trustee the same powers and title with respect to the debtor and its property, and the same rights to avoid preferences, as a trustee in bankruptcy and a trustee under Chapter X of the Bankruptcy Act would have. In addition, the trustee is given the right to operate the debtor's business so as to complete certain open contractual commitments and, with SIPC approval, to hire and fix the compensation of persons deemed necessary by the trustee for purposes of the liquidation proceedings, all without court approval.

The duties of the trustee, except where inconsistent with the 1970 Act or as otherwise ordered by the court, are the same as the duties of a trustee in bankruptcy.³¹

A liquidation proceeding is to be conducted:

"in accordance with, and as though it were being conducted under, the provisions of chapter X and such of the provisions (other than section 60e) of chapters I to VII, inclusive, of the Bankruptcy Act as section 102 of chapter X would make applicable if an order of the court had been entered directly that bankruptcy be proceeded with pursuant to the provisions of such chapters I to VII, inclusive...."

As indicated, where inconsistent with the provisions of the 1970 Act, the Bankruptcy Act does not apply. As a result, the above quoted provision effects a blending of the 1970 Act, the provisions of the Bankruptcy Act dealing with ordinary bankruptcy (Chapters I to VII, inclusive) and the provisions of the Bankruptcy Act dealing with corporate reorganization (Chapter X). Such a blending was intended to provide the court and the trustee with the flexibility necessary to the proper conduct of a complex proceeding.³²

The 1970 Act specifically excludes Section 60e of the Bankruptcy Act which had governed the bankruptcy liquidation of stockbrokers.³³

Prior to enactment of Section 60e in 1938, the rights of customers of stockbrokers depended upon the law of the state in which the transactions in question took place, and most cases involved the rights of margin customers. Two doctrines, the "Massachusetts" rule and the "New York" rule, emerged. Under the Massachusetts rule, a broker who carried stock in a margin account for customers was treated as the owner of that stock. The relationship between the parties was said to be that of debtor and creditor, with the customer treated as a general creditor. Under the New York rule, which was followed in most jurisdictions, the relationship was viewed as one of pledgor-pledgee, and a customer who could find similar securities in the possession of the stockbroker or the stockbroker's pledgee could reclaim them. Thus under the New York rule some customers might fare well and others fare poorly, depending simply upon which customers were lucky enough to discover that the stockbroker had in his possession some of the kinds of securities in which they had an interest.

Section 60e of the Bankruptcy Act was enacted primarily to correct the inequities caused by the operation of the New York rule. The section's major feature was the establishment of three classes of claimants to a stockbroker's assets. These three classes have been adopted, with minor changes, by the 1970 Act.

Section 6(c)(2)(C) of the 1970 Act establishes as one class those customers who are able to "specifically identify" their property in accordance with the terms of that section and who are entitled to the immediate possession of such property without the

³¹ However, the trustee in a 1970 Act proceeding has no obligation to reduce securities to money.

³² However, the blending also creates certain problems, in that there are conflicts between certain provisions of Chapters I through VII of the Bankruptcy Act and Chapter X of that Act. In addition, the major purpose of a Chapter X proceeding (the rehabilitation of the debtor) is inconsistent with one of the major purposes of a SIPC proceeding (the liquidation of the debtor), while certain provisions of Chapters I through VII which conflict with provisions of Chapter X are perfectly consistent with the purposes of a SIPC proceeding. SIPC is attempting to resolve these conflicts as they appear in any particular case.

³⁵ Section 60e continues to govern a bankruptcy liquidation of a stockbroker not a member of SIPC.

payment of any sum to the debtor. Specifically identifiable property includes property which "remained in its identical form in the debtor's possession until the filing date . . . [or which] was allocated to or physically set aside for such customers on the filing date." § 6(c)(2)(C). Cash, while it can be specifically identifiable property of a customer (e.g., when found in an envelope with the customer's name on it or, for instance, an uncashed check or monies held for a particular payment in a separate account), usually does not fit within this definition.

The Section 60e definition of specifically identifiable property was very similar, though it required that property be physically set aside for or allocated to customers while the stockbroker was solvent or for four months before bankruptcy. Stock was usually not considered specifically identified unless tagged with the customer's name or account number or segregated individually. The 1970 Act refines and expands the Section 60e concept of specifically identifiable property to include securities held in "bulk segregation" or as part of a central certificate service.

In November 1972 the Commission adopted its Rule 15c3-3 under the 1934 Act. The rule became effective on January 15, 1973 and will apply in SIPC liquidations instituted on or after that date. Among other things, this rule may operate to affect the rights of customers materially in a SIPC liquidation. The rule requires a broker-dealer firm to establish certain cash reserves according to a formula which is designed in general to limit the use of customer generated funds to particular customer related activities. The rule also requires a broker-dealer to obtain and maintain possession or control of all fully paid and excess margin securities carried for the account of customers. The rule then provides, as authorized by Section 6(c)(2)(C) of the 1970 Act. that the cash and securities subject to these reserve and custody limitations shall constitute the specifically identifiable property of customers. In view of their importance, the provisions in question are restated here:

"(j) Specifically Identifiable Property. For the purpose of Section 6(c)(2)(C)(iii) of the Securities Investor Protection Act of 1970 the following are hereby determined to be allocated to and shall constitute the specifically identifiable property of customers:

(1) All fully-paid and excess margin securities in the physical possession or control (including any such securities under the control of the broker or dealer in which a customer can demonstrate ownership rights where the condition of the books or records of the broker or dealer may otherwise fail to accurately reflect such rights) of the broker or dealer or in transfer or stock dividend receivable shall constitute the specifically identifiable property of customers having claims for fully-paid and excess margin securities as their interests may appear from the books or records of the broker or dealer or as is otherwise established by a preponderance of the evidence or to the satisfaction of a trustee appointed pursuant to Section 5(b) of that Act.

(2) The cash and qualified securities on deposit in the Reserve Bank Account of a broker or dealer shall be deemed to be the specifically identifiable property of those customers of the broker or dealer who have free credit balances.

(3) If specifically identifiable property allocable to customers pursuant to paragraph (j)(1) or (j)(2) is insufficient to satisfy the respective claims of such customers, such specifically identifiable property shall be pro-rated among such customers in accordance with their respective interests.

(4) If the specifically identifiable property allocable to either of the specified classes of customers referred to in paragraph (j)(1) or (j)(2) exceeds their aggregate claims against such property, such excess shall thereafter constitute part of the "Single and Separate Fund" provided for in Section 6(c)(2)(B) of that Act."

A second class are those customers entitled to share pro rata in a "single and separate" fund.³⁴

Finally, to the extent that a customer's claim is not satisfied from the foregoing sources and advances from SIPC, he shares with other creditors in any remaining assets in the debtor's estate.

The 1970 Act attempts to eliminate certain problems which arose in the application of Section 60e. For example, while Section 60e deals with insolvent "stockbrokers", the term "stockbroker" is not defined in the Bankruptcy Act. It has been stated that the term refers only to those holding customers' securities as agents, rather than those dealing with customers as principals. Gordon v. Spalding, 268 F. 2d 327, 330-331 (CA. 5, 1959). The 1970 Act clearly covers both brokers and dealers.³⁵

Another problem arising under Section 60e involved the definition of the term "customer." A person leaving cash with a broker for the purpose of purchasing securities might not be considered a "customer" if the purchase did not occur prior to bankruptcy. The 1970 Act remedies this by providing that the term "customer" "... shall include any person who has deposited cash with the debtor for the purpose of purchasing securities ..." §6(c)(2)(A)(ii).

³⁴ The single and separate fund consists of: "All property at any time received, acquired, or held by or for the account of a debtor from or for the account of customers, except cash customers, who are able to identify specifically their property in the manner prescribed in sub-paragraph (C), and the proceeds of all customers' property transferred by the debtor, including property unlawfully converted. . . ." §6(c)(2)(B).

³³ See page 7 for a discussion of the types of brokers and dealers covered by the 1970 Act.

One of the major innovations of the 1970 Act is the provision for the completion of open contractual commitments. Section 6(d) states that:

"The trustee shall complete those contractual commitments of the debtor relating to transactions in securities which were made in the ordinary course of debtor's business and which were outstanding on the filing date—

- (1) in which a customer had an interest, except those commitments the completion of which the Commission shall have determined by rule or regulation not to be in the public interest, or
- (2) in which a customer did not have an interest, to the extent that the Commission shall by rule or regulation have determined the completion of such commitments to be in the public interest."³⁶

SIPC has been working on drafts of proposed rules under this Section which it is hoped the Commission will adopt in the near future.

Other than specifically identifiable property of customers which is not the subject of an open contractual commitment, all property held by or for the debtor and all property in the single and separate fund may be used to complete open contractual commitments. In addition, SIPC may be required to advance monies necessary to complete certain open contractual commitments of the debtor in which customers have an interest.

Section 6(e) of the Act prescribes that promptly after his appointment the trustee will publish a notice of the commencement of the proceedings in appropriate newspapers. As promptly as possible the trustee is to mail a copy of the notice to each of the customers of the debtor.

Except as the trustee may otherwise permit, claims for certain specifically identifiable property and certain claims payable from the single and separate fund are not to be paid, other than from the general estate of the debtor, unless filed within such period of time (not exceeding 60 days) as may be fixed by the court. No claim may be allowed which has not been filed within six months, except as provided in Section 57 of the Bankruptcy Act.

Advances

Section 6(f) deals with SIPC advances to trustees, subsection (1) relating to advances for customers' claims. To provide for prompt payment and to satisfy the net equities of customers of the debtor, SIPC is to advance to the trustee monies to satisfy claims in full of each customer, but not to exceed \$50,000 for such customer. The amount advanced by reason of such claim to cash shall not exceed \$20,000.³⁷

A customer who holds accounts with the debtor in bona fide separate capacities is considered a different customer in each capacity. In October 1971, SIPC issued Rules Identifying Accounts of Separate Customers of SIPC Members.

No advance may be made by SIPC to the trustee to satisfy any claims of any customer who is a general partner, officer, or director of the debtor, the beneficial owner of 5 percent or more of any class of stock, or limited partner with a participation of 5 percent or more in net assets or net profits of debtor. No advance shall be made by SIPC to the trustee to satisfy the claims of any broker or dealer or bank unless such claims arise out of transactions for customers of such broker or dealer or bank, in which event, each such customer shall be deemed a separate customer of the debtor.

SIPC may advance to the trustee such monies as may be required to hire and pay all personnel that are necessary for the liquidation proceeding and to pay proper administrative expenses. SIPC is to advance to the trustee monies required to complete open contractual commitments.

Section 6(g) of the Act requires the trustee to discharge promptly all obligations of the debtor to each of its customers relating to, or net equities based upon, securities or cash by the delivery of securities or the payment of cash to customers insofar as such obligations are ascertainable from the debtor's books and records, or are established to the satisfaction of the trustee.³⁸ The court is empowered to (1) authorize the trustee to make pay-

³⁶ "For purposes of [Section 6(d)] (but not for any other purpose of this Act) (i) the term 'customer' means any person other than a broker or dealer, and (ii) a customer shall be deemed to have had an interest in a transaction if a broker participating in the transaction was acting as agent for a customer, or if a dealer participating in the transaction held a customer's order which was to be executed as a part of the transaction," § 6(d). In other words, a customer is deemed to have an interest in a transaction if the broker or dealer was acting for a customer either in an agency or principal capacity.

³⁷ In other words, advances to cover customer losses may not exceed \$50,000 but if the claim is one for cash the advance to cover customer losses may not exceed \$20,000. The "filing date" (see page 19) is the critical date for computing "net equities." ³⁸ The statute contemplates that in the interest of mat

The statute contemplates that in the interest of maintaining public confidence and minimizing the period during which investors' property is not available to them for invest ment or other purposes, customer claims should be paid promptly. SIPC agrees with this objective and believes that procedures now employed and being developed should result, in many cases, in the payment of non-disputed claims within a few months. However, SIPC also has taken the position that advances should not be made until the trustee and SIPC are satisfied that claims are bona fide and accurate. Experience to date has warned of the need to be watchful for fraudulent and erroneous claims. The state of the books and records frequently is such that it is possible for claims to be misstated under circumstances making difficult the detection and prevention of overpayments or improper payments. In some cases the staff has been alerted to the probability that plans have been made to establish accounts for the purpose of reaching SIPC funds. SIPC has followed a practice, therefore (which in no way is to be construed as a reflection on any trustee), of having its own accountants review debtor accounts.

ment out of SIPC advances for claims for securities or cash; and (2) in respect of claims for securities, authorize the trustee to the greatest extent practicable to deliver, in payment of claims of customers for their equities based on securities held on the filing date in their accounts, securities of the same class and series of an issue ratably up to the respective amounts so held in those accounts. The amounts of such advances are indicated in Appendix I.

Any payment or delivery of property by the trustee may be conditioned upon requiring claimants to file in support of their claims appropriate receipts, supporting affidavits, or properly executed assignments. Trustees have generally required copies of confirmations, cancelled checks, and statements of account in support of claims filed. Trustees have, from time to time, disallowed various claims. The nature of any additional data in support of claims has been a matter for the individual trustee to work out with the claimant, depending on the specific circumstances relating to the disallowance.

SIPC is entitled to be repaid, in priority to all other claims payable from the single and separate fund, the amounts of all advances made by SIPC to the trustee to permit the completion of open contractual commitments and, except to the extent that other assets of the debtor may be available or as otherwise ordered by the court to be paid, all costs and expenses specified in clauses (1) and (2) of Section 64(a) of the Bankruptcy Act in priority to claims of customers against the single and separate fund.

The statute also provides that, to the extent that monies are advanced by SIPC to the trustee to pay claims of customers, SIPC shall be subrogated to the claims of such customers.

Selection of Trustees

As of December 31, 1972, there were 64 trustees engaged in liquidations under the 1970 Act. In 10 instances a trustee who had substantially completed the payment of customer claims in a SIPC liquidation was designated as trustee in a second case. It has been found that experience gained during one liquidation is invaluable in reducing the time and cost involved in a second liquidation. Of the 64 trustees, 25 had been receivers appointed by the court prior to the time SIPC filed an application. SIPC designated them as trustees for purpose of the 1970 Act when the court approved SIPC's application. In one case SIPC designated the receiver to serve as counsel to the trustee.

The trustees serving in 38 cases were not receivers at the time SIPC applications to the court were

made and therefore were selected by SIPC and designated by it pursuant to the provisions of the Section 5(b)(3) of the 1970 Act. In all cases of selection of trustees and their counsel, SIPC endeavors to find competent persons who have experience in brokerdealer operations, securities law, and bankruptcy law. SIPC constantly seeks recommendations from the SEC's regional offices, NASD district offices, recognized experts in the above areas, the judiciary, and any others who may know of individuals competent to undertake these important assignments. SIPC has designated lawyers, accountants, and retired businessmen to serve as trustees.

In the vast majority of the liquidations to date, the creditors and the debtor's estates have been well served by the men and women holding office as trustees and their counsel. SIPC recognizes the tremendous contribution they have made to the effective administration of debtors' estates pursuant to the provisions of the Act. There have been a few instances where trustees have not administered the estate with the vigor and dispatch which seemed called for. In these instances SIPC, through its staff accountants and lawyers, has sought to provide the necessary impetus to move the proceeding along. It has been necessary for SIPC to ask for the resignation of one trustee and the appointment of a substitute trustee where it was determined to be impracticable to add the duties of trustee to an already overburdened personal work load.

SIPC has continued its efforts to develop a roster of persons in all parts of the country experienced in the various operational aspects of the brokerage business and otherwise qualified by experience, training or profession who might be willing to act as a trustee in a SIPC liquidation. The names of prospective accountants and counsel qualified and willing to undertake the work of assisting trustees have also been accumulated. This has made it possible to secure the services of highly qualified personnel on short notice for key roles in SIPC liquidations.

In one case the district court refused to appoint a trustee pursuant to a SIPC application. This action was subsequently reversed by the Court of Appeals (see page 31).

Basic Causes of Failures of Firms Being Liquidated

As of December 31, 1972 SIPC was involved in the liquidation of 64 securities firms by court-appointed trustees. These firms were in all stages of the liquidation process. In 32 cases, the claims of customers had been settled or substantially settled and trustees were involved in later stages of dealing with the general estates and the claims of other creditors. In another 12 cases the claims of customers had been settled or substantially settled by March 31, 1973. In the remaining cases assets were being marshalled, claims processed and customers paid net equities or delivered specifically identifiable property. In some, disputed claims were being researched. In others, litigation was being undertaken to recover assets.

Inquiries have been made of the trustees and the reports of the staffs of the self-regulatory agencies have been reviewed in an effort to determine the causes of failure of these firms. In view of the fact that investigations into fraud and misconduct are continuing in a number of them, it is not believed advisable to publish the specific details of pending cases. On the basis of the data so far available SIPC has prepared some summary statements regarding causes for failure without disclosing the names of firms or the trustees and without linking the data with any firm or persons. Illustrative summary statements of the reasons for the failure of firms in liquidation as of December 31, 1972 are set forth in Appendix II.

Inadequate, inaccurate or nonexistent books and records must be mentioned as one of the most significant conditions encountered in almost all of these cases. In a number of instances records have been falsified and customers' accounts manipulated by the principals. This failure of record keeping has led in some cases to a loss of control of the business. The work of the trustees in all of these cases has been impeded in varying degrees by bad records, no records, false records or non-current records. In some situations it has been impossible for trained accountants to reconstruct the books and records needed by the trustee.

In many cases, the operating management did not have the qualifications or experience needed to operate a general securities business. Principals did not possess the knowledge of complicated trading procedures or basic concepts of good management and control over securities operations. Many were ignorant of brokerage accounting and regulatory rules and regulations.

Lack of adequate capital has been mentioned by the trustees as a major factor in firm failures. Of course, this explanation by itself is not too revealing as an indication of the reason for failures. This condition may result from a number of reasons ranging from too small a capital base to such matters as temporary illiquidity, over-commitment in a particular security or venture, inability to absorb an adverse market movement, too rapid expansion or improper controls. There was over reliance on subordinated capital in a number of instances. In others, the subordination was improperly executed or fraudulently induced. The initial capital of the firms in liquidation as reflected in the broker-dealer registration forms is shown in Appendix 1. Figures on initial capital were available for 63 of the 64 firms. The firm reporting the smallest initial capital began business in 1964 with \$4,000. The firm with the largest initial capital started business in February 1970 with \$250,000 and failed within two years.

Fifty of the 63 firms, or approximately 80%, reported an initial capital of less than \$50,000; 30 of the 63 firms, or approximately 48%, reported an initial capital of less than \$25,000; and 11 reported capital of less than \$10,000.

Of the firms in liquidation, 49 had been in business five years or less and 19 under two years. Expressed on a percentage basis 77% of the liquidation were in business five years or less and 30% two years or less.

Mismanagement likewise has been stated frequently as a major factor. This may stem from a lack of knowledge and experience in the business, emphasis on sales to the exclusion of other aspects of the business, ineptitude, failure of records or controls or other matters such as, for example, conduct reflecting on the integrity of the principals or their key employees.

The matter of fraud and manipulation which has surfaced in a number of cases must be recognized as a major factor in these failures. Customer securities and funds were fraudulently used in the business including improper use of discretionary accounts. There were several market makers and underwriters of low grade, highly speculative issues where prices were inflated and customer accounts manipulated to maintain these prices. Heavy concentrations in a few speculative issues and imprudent trading activities contributed to other failures.

Generally, failures have resulted from various combinations of the foregoing which may be noted in Appendix II

Reasons for failures of sixty-four firms are:

Reasons	Number of Firms
Poor books and records	44
Misconduct	26
High operating costs—poor controls	21
Mismanagement	28
Lack of knowledge of securities busines	s 18
Adverse market conditions	10
Dealing in highly speculative issues	29

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Firms in Liquidation
By Years In Business and Comparison With
Firms Reported in Financial Difficulty in January 1973

		Thru 12/31/72 64 Firms In Liquidation			During January 1973 NASD Reported to SIPC 28 Firms Which Were in or Approaching Financial Difficulty		
Years in		Cumulative			Cumu!ative		
Business	No.	No.	%	No.	No.	%	
0-1	3	3	5	3	3	11	
1-2	16	19	30	8	11	39	
2–3	18	37	58	7	18	64	
3–4	8	45	70	2	20	71	
4–5	4	49	77	4	24	86	
5-10	9	58	91	3	27	96	
10 & over	6	64	100	1	28	100	

Twenty-five of the 28 firms reported in January 1973 were in net capital violation and the records of two were in such condition that it was impossible to determine whether a net capital violation existed. Ten of the 28 firms reported to SIPC in January had books and records deficiencies. As of March 31 six of these firms had become SIPC liquidations. Two of the five had been in business two years or less, two between two and three years, one between three and four years and one in business for seven years.

The distribution of broker-dealer firms in liquidation in twenty-one states is as follows:

State		Number of Firms
Alabama Arizona California Delaware Florida Georgia Illinois Kansas Massachusetts Minnesota Missouri Montana New Hampshire New Jersey New York:		1 1 1 2 2 5 1 1 5
New York City Other Pennsylvania Tennessee Texas Utah Washington Wisconsin	21 	28 1 1 2 1 1 64

It would be helpful to the Commission and selfregulatory agencies if the records and history of firms being liquidated under the procedures of the Act could be reviewed thoroughly and case studies prepared as to the causes of failures. As a practicable matter, experience to date suggests that it may not be possible to prepare any thorough analysis because of the absence or unreliability of records.

Extensive data can be compiled on the qualifications, background, experience and training of personnel, types of securities handled, and other general aspects of a firm's operations as well as significant aspects of the liquidation process, procedures and results, including costs. In addition, it is evident that a continuing study should be made of the surveillance systems employed by the self-regulatory agencies and in particular the surveillance records for failing firms.

This work ultimately should assist SIPC to reach conclusions and make recommendations concerning such matters as inspections, reporting, record keeping, qualifications of principals (Sections 7, 8, 9 and 10), accounting requirements and, with other data to be developed, with respect to various criteria for determining varying rates of assessments which must be devised in due course.

Considerable progress has been made during the past year in one of SIPC's most important and continuing functions, i.e., the preparation and updating of guides and instructions for the benefit of trustees, their employees and our own personnel, in the various stages of the trustees' functions in liquidations.

Finally, the experience gained in working with the problems of failing broker-dealers and their customers will be of value in suggesting changes in the rules or procedures of the Commission or the selfregulatory organizations in relation to the reporting requirements and need for inspections or monitoring of SIPC member firms.

The long-range objective of the regulatory and self-regulating structure, in addition to upgrading the financial responsibility of SIPC member firms generally, of course, is to identify and correct if possible the causes of failures or, if that cannot be wholly realized, to devise a system under which customer losses and SIPC's costs may be minimized. SIPC's role in liquidation proceedings, once a trustee has been appointed, is far from passive. Many questions arise as to the proper interpretation of the Act, and disputes as to these interpretations have on occasion led to litigation. In addition, in several instances actions have been brought to compel SIPC to take action to seek the appointment of a trustee in situations in which SIPC believed that the Act was not intended to apply.

Discussed below are the more important matters involving SIPC in litigation during the year.

Proceedings against Alan F. Hughes, Inc. (SEC v. Alan F. Hughes, Inc., USDC ND N.Y., 71 Civil Action No. 379) were initiated by complaint of the Commission filed on August 18, 1971, alleging violation of various provisions of the Securities Exchange Act of 1934, and rules promulgated thereunder, relating to record keeping, net capital, and securities hypothecation requirements. The complaint requested both a permanent injunction against further violations and the appointment of a receiver. On September 7, 1971, the court, upon consent of Alan F. Hughes, Inc. ("Hughes") granted the injunction but, instead of appointing a receiver, appointed a Special Fiscal Agent to examine the books and records of the firm and to report to the court as to the need for a receiver or for the liquidation of the firm.

In a fully documented report filed on October 27, 1971, the Special Fiscal Agent stated that the firm's books and records were "so unreliable

curate, incomplete and misleading that

unusable." In addition, he advised the court that the firm had engaged in actions which were more than mere technical violations of law.

On December 13, 1971, the court appointed a receiver to act until such time as a trustee under the 1970 Act was appointed. Hughes filed a notice of appeal from the court's order, but did not at that time seek a stay thereof.

On SIPC's application, the court on January 17, 1972, adjudicated the customers of Hughes to be in need of protection under the Act and appointed a trustee.

Hughes then requested the court, among other things, to stay, pending appeal, the appointment of the receiver and trustee and to stay, pending appeal, all liquidation proceedings. This relief was opposed by SIPC and was denied on February 22, 1972. It was, however, agreed among the parties that no actual liquidation would take place pending appeal. On appeal, Hughes contended that it had been denied due process of law in that SIPC had failed to provide it with notice and opportunity for hearing as to its determination of danger to customers. SIPC urged, and the court of appeals held, that:

"[D]ue process does not require that an opportunity for a hearing be afforded at the time SIPC makes its initial determination that one of its members has failed or is in danger of failing to meet its obligations to its customers and that there exists one or more of the conditions specified in § 5 (b)(1)(A). That initial determination, in and of itself, has no binding legal consequences and deprives no broker-dealer of property.

Under the 1970 Act, we hold that due process is satisfied as long as the district court, after providing the broker-dealer with an opportunity to be heard, makes its own determination that the brokerdealer has failed or is in danger of failing to meet its obligations to its customers.

Further, we conclude that, consonant with the requirements of due process, such a determination must result from a *de novo* proceeding in the district court rather than from some lesser process merely involving judicial review of the initial administrative determination."

SEC v. Alan F. Hughes, Inc., 461 F. 2d 974, 979 (C.A. 2, 1972).

SIPC argued, and the court of appeals found, that Hughes had in fact been granted a hearing in the district court and that the court had in fact made its own determination that there was a danger to Hughes' customers. Indeed, the court concluded, "Here justice was done and done well."

The court of appeals also rejected, as SIPC had urged, the contention by Hughes that there was insufficient evidence to support a finding of danger to customers.

In the proceeding for the liquidation of Aberdeen Securities Co., Inc. (SEC v. Aberdeen Securities Co., Inc., USDC D. Del., Civil Action No. 4224-1971), a customer objected to the trustee's proposed distribution to him, in full satisfaction of his claim for 400 shares of a particular stock, of a pro rata portion of shares of that stock in the debtor's possession and cash in lieu of the missing shares valued as of the filing date. The customer demanded that he be given the 400 shares which he claimed and that Section 6(d) of the 1970 Act required SIPC to advance to the trustee whatever funds might. be necessary to enable the trustee to purchase those shares in the open market. Alternatively, the customer urged that he was entitled to the market value of the securities as of the date on which he had demanded their delivery or as of the date on which payment was actually made, whichever was higher. As a third alternative, the customer claimed that he could elect to take either the market value of the securities as of the filing date or the *prompt* distribution of the securities, but that if such distribution was not prompt, he could elect to take the highest market value reached between the filing date and the date of payment.

The customer further requested the court to allow his claim to proceed in the form of a class action pursuant to Rule 23 of the Federal Rules of Civil Procedure.

SIPC and the trustee took the position that Section 6(d) was not applicable to ordinary purchase or sale commitments between a debtor and his customer; that the customer was entitled to his pro rata share of those securities claimed by him which were actually available to be delivered to him and to cash in lieu of the missing securities valued as of the filing date; and that a class action was inappropriate and unnecessary in that, among other reasons, all persons similarly situated were already before the court.

The district court upheld the contentions of SIPC and the trustee; the customer appealed and the matter is now pending before the United States Court of Appeals for the Third Circuit.

On September 26, 1969, more than a year before the effective date of the Act, the broker-dealer firm of Sudler, Hart & Co. was adjudicated bankrupt. The bankruptcy trustee filed an action against the SEC and SIPC seeking to compel the SEC to notify SIPC, pursuant to the provisions of Section 5 (a)(1) of the Act that Sudler, Hart (which was still registered as a broker-dealer under the 1934 Act) was in financial difficulty, and seeking to compel SIPC to take action for the protection of the customers of Sudler, Hart pursuant to the Act. The trustees argued that Sudler, Hart was a member of SIPC and that there was a mandatory duty imposed upon SIPC to take action to protect the financial interests of customers of its members.

SIPC and the SEC moved to dismiss the trustee's complaint for failure to state a claim upon which relief could be granted, on the ground that to apply the statute to a broker-dealer who was adjudicated a bankrupt more than one year before the effective date of the Act would be to give the Act retroactive effect, and that not only was there no provision for such retroactive effect in the statutory language, but the legislative history of the Act clearly demonstrated that Congress did not intend the Act to be applied in such a manner.

The district court agreed with SIPC and the SEC

and held that the Act was not intended by Congress to apply retroactively; that in order to be covered by the Act, the broker-dealer must have been registered with the SEC and doing business as such on or after the effective date of the Act; and that to apply the Act to this particular broker-dealer would in fact be a retroactive application of the Act. Therefore, the district court granted the motion of SIPC and the SEC and dismissed the complaint.

The trustee appealed and essentially the same issues were presented to the court of appeals, which held that the Act did not extend coverage to customers of the plaintiff which was adjudicated bankrupt prior to the effective date of the Act. This holding was based not on the ground that such an application of the Act would be to give it retroactive effect, but rather upon the ground that, the firm having gone out of business before the effective date of the Act, it "did not have the status of a broker or dealer for the purposes of the Act" on the effective date thereof. Lohf v. Casey, 466 F. 2d 618 (CA 10, 1972).

In Securities and Exchange Commission v. Guaranty Bond and Securities Corporation (USDC MD Tenn., Civil Action No. 5989), the SEC on December 22, 1970, filed a complaint against Guaranty Bond and Securities Corporation ("Guaranty Bond") and requested the court to enjoin that firm from further violations of the federal securities laws. On January 6, 1971, the court granted the injunction, having found that Guaranty Bond had violated the Commission's net capital rule (17 C.F.R. 240.15c3-1) and that said violation had existed for a substantial period of time prior to the filing of the complaint.

On January 29, 1971, a receiver was appointed. This receiver commenced the administration and liquidation of the estate of Guaranty Bond and at least two related non-broker-dealer firms-Guaranty Bond Company (Guaranty Bond's parent) and Building Associates. Not until May 27, 1971, after substantially completing said liquidation, did the receiver make demand upon SIPC for 1970 Act protection for the customers of Guaranty Bond. His demand was SIPC's first notice that the firm was in financial difficulty.

SIPC resisted the receiver's demand, arguing, among other things, that the application of the 1970 Act to this case would be to give it unlawful retroactive effect and that, even if that were not the case, the special circumstances involved, including the fact that the liquidation had already been accomplished without regard to the special requirements of the Act, precluded the application of the Act.

Without reaching the second argument, the court, on January 10, 1973, held that, inasmuch as the

firm has been both hopelessly insolvent and in net capital violation prior to the effective date of the Act, to grant the receiver's demand ". . . would be a retroactive application of the Act and a clear frustration of legislative intent." The receiver has filed a notice of appeal from the district court's decision.

Bohart-McCaslin Ventures, Inc. v. Midwestern Securities Corp. (USDC ND Tex., Civil Action No 2-1119) involved a suit by certain creditors of Midwestern Securities Corporation ("Midwestern") against Midwestern and SIPC. The plaintiffs sought a decree to the effect that they were in need of and entitled to the protections provided by the 1970 Act.

SIPC moved to dismiss the complaint on the grounds that the activities and actions of Midwestern which were complained of took place prior to December 30, 1970, the effective date of the Act, and the Act could not be applied so as to provide retroactive protection; and that in any case, pursuant to Section 7(b) of the Act, only the SEC had standing to bring suit against SIPC to force it to take action for the protection of customers.

The SEC, on November 7, 1969, requested that Midwestern be enjoined from committing certain violations of the federal securities laws, and a permanent injunction to that effect was entered on December 17, 1969. On June 3, 1970, the SEC moved for the appointment of a receiver for Midwestern, and that receiver was appointed on February 19, 1971. Since the entry of the permanent injunction, Midwestern had neither transacted business with public customers nor carried on the other normal operations and activities of a broker-dealer.

The court granted SIPC's motion to dismiss, stating that the legislative history of the Act made it clear that "customers of companies in serious difficulty prior to the effective date of the Act were not intended to enjoy the protection of the SIPC." Citing the case of Lohf v. Casey, discussed above, the court held that customers of Midwestern were not entitled to SIPC protection because, as of the effective date of the Act, the firm, having ceased doing business, did not occupy the status of a broker-dealer which the Act was intended to cover.

The decision in the Midwestern Securities Corporation case included a further and important holding by the court. As a separate ground for dismissing the suit against SIPC, the court held that under the 1970 Act only the SEC has the authority to bring suit to compel SIPC to liquidate a failed brokerdealer. That case marked the first occasion on which SIPC, prompted by the prospect of additional similar suits, urged that no party except the SEC has standing to compel a review of SIPC's determination not to liquidate a broker-dealer.

In the liquidation of Security Planners Ltd., Inc. (SEC v. Security Planners Ltd., Inc., USDC D Mass., Civil Action No. 71-656-M) three and one half months elapsed between the filing of the SEC's complaint and the appointment of a temporary receiver. During this period, the business of the debtor was in the hands of the principals, who continued to operate it. A large number of customers bought or sold securities through the debtor during this period, and many of them never received their securities or the proceeds of the sales. SIPC's application was filed after the appointment of the temporary receiver.

The 1970 Act requires trustees to pay to customers their net equities based on claims for cash and securities, computed as of the "filing date," and requires SIPC to make advances up to certain limits where necessary to pay such net equities. The term "filing date" is defined in such a manner that, where a receiver has been appointed before SIPC files its application for the appointment of a trustee, the filing date is deemed to be not the date on which SIPC filed its application, and not the date on which a receiver was appointed, but the date on which the complaint requesting the appointment of a receiver was filed. Thus, in this case the filing date was March 18, 1971, the date on which the SEC filed its complaint, and substantial customer claims arose after that date but before the appointment of the receiver three and one half months later. There was, therefore, a substantial question as to whether customers whose claims arose after the filing date were entitled to protection under the Act, since, technically speaking, they had no net equity on the filing date.

The trustee, with the support of SIPC, filed a petition for an order determining:

- 1. That bona fide customer claims arising out of securities transactions entered into during the three and one-half month period between the filing date and the date on which the receiver was appointed, be classified and treated pari passu with the customer claims arising out of securities transactions entered into before the filing date;
- 2. That such claims should be valued as of the dates on which they arose; and
- 3. That customers having such claims should be entitled to the protection afforded by the Act.

In its memorandum in support of the trustee's petition SIPC pointed out that, with certain exceptions and additions, the Act requires liquidation proceedings to be conducted in accordance with the

provisions of Chapter X of the Bankruptcy Act, and that Section 201 of Chapter X (11 USC § 601) provides in pertinent part:

"All claims arising after the filing of a petition under this Chapter and before the qualification of a receiver or trustee . . . shall be provable."

The customers in question presumably had no reason to believe that the debtor was the subject of a pending action by the Commission; the debtor was not prevented by any court action from doing business during the period after the filing date, and certainly the customers had no reason to believe that the technical dating back provisions of the 1970 Act would operate to bar their claims as customers upon the subsequent appointment of a receiver or trustee. In addition, the legislative history has made it clear that the SIPC fund was to be available for the protection of public customers when that protection could be provided within and consistent with the substantive provisions of the Act. Therefore, SIPC argued that since Section 201 of Chapter X is applicable in a liquidation proceeding, it should be applied in such a way as to treat claims arising after the filing date but before the qualification of a receiver as if they had existed on the filing date.

The court granted the trustee's petition.

Certain of the customers who had placed orders for securities after the filing date and who had paid for those securities moved the court for an order directing the trustee to complete what they believed to be their "open contractual commitments" within the meaning of Section 6 (d) of the Act. In addition, these customers attempted to have their petition treated as a class action.

SIPC opposed the customers' petition on the grounds that Section 6 (d) of the Act did not contemplate the type of transaction entered into by these customers and that a class action was inappropriate to this type of proceeding. The court agreed with SIPC and on June 23, 1972, handed down a memorandum decision denying the customers' motion to compel the trustee to complete the contractual commitments. The court held that the transactions were "not such as were intended to be covered by Section 6(d) of the SIPC Statute. . . . The section appears to have been designed to deal not with all orders placed with the insolvent broker but rather with those involving inter-broker orders which were incomplete on the date of filing. Such an interpretation of the statute would be consistent with the intent evidenced in the House Report to confine brokerage failures as narrowly as possible."

In addition the court determined that the class

action rule was not appropriate to this case, stating that:

"In a liquidation, the claims of each customer should be dealt with under the statute separately, and an individual determination made of the liability of SIPC to each customer. This procedure necessarily involves the determination of each affected person and an individual judgment. The class action rule was designed for cases where it was impractical to locate or identify each affected party and where general relief was appropriate."

On January 15, 1971, upon the petition of the SEC, a receiver was appointed for Karle R. Berglund d/b/a Colonial Investment Securities (SEC v. Milner, USDC D. Mass., Civil Action No. 71-99-G). In February, 1971, the receiver petitioned the district court for leave to continue Colonial's business, on the ground that a sale of its assets was being negotiated and therefore it was important to preserve its assets consisting principally of its sales force, customers, and arrangements with mutual funds. The petition was allowed, but the continuation of the business was to be limited to the solicitation of mutual fund sales and Karle R. Berglund was to have no part in the management of the business.

Despite the court's order, the firm, apparently under Berglund's direction, continued to engage in a general securities business and incurred liabilities to its customers.

Subsequently, a co-receiver was appointed by the court. In April 1971, the assets of Colonial were sold, free from liability, for \$70,000. The first receiver subsequently died.

In August, 1971, on the application of SIPC, the co-receiver was appointed as trustee for the liquidation of the business of Colonial. The trustee proceeded with the liquidation and eventually prepared a plan of distribution of \$58,000 left on hand from the proceeds of the sale of Colonial's assets. The entire amount was to be distributed in payment of expenses of administration incurred during the receivership. Most of the money would go to customers to whom liabilities had been incurred after the receiver had been appointed; the balance would go to salesmen for net commissions and for goods and services then received, and to reimburse SIPC for certain advances for administration expenses.

Certain salesmen and general creditors appealed from the order authorizing the distribution pursuant to the trustee's plan, which had the support of SIPC.

The court of appeals refused to entertain most of the legal issues raised by the appellants, due to their failure to raise them properly in the court below. But the court did consider one particular issue: the question of whether the remaining property could be paid out as administrative expenses for liabilities incurred during the receivership.

After the close of the calendar year, the court of appeals vacated the district court's order and remanded with directions to the district court to consider the appropriateness of treating the claims which arose during the receivership as expenses of administration. SEC v. *Milner*, CA 2, No. 72-1291, February 20, 1973.

In the liquidation of Robert E. Wick d/b/a Robert E. Wick Company (SEC v. Robert E. Wick d/b/a Robert E. Wick Company, USDC ND III., Civil Action No. 72C647) the question arose as to whether, where the debtor is a sole proprietor, the Act contemplates a complete liquidation of all of the debtor's assets and liabilities, or only of those assets and liabilities which relate to the debtor's securities business.

The trustee took the position that the Act applied only to the assets and liabilities relating to the debtor's securities business, arguing, among other things, that to give the trustee and the court jurisdiction over the debtor's non-business assets and liabilities would, in effect, make the proceeding for all practical purposes a bankruptcy proceeding and that the debtor would thereby be deprived of certain fundamental safeguards provided by the Bankruptcy Act.

SIPC, on the other hand, took the position that the Act did in fact contemplate the administration and liquidation of all of the debtor's assets and liabilities, both "personal" and "business", arguing, among other things, that there could be no differentiation between those assets and liabilities related to the debtor's securities business and those related to his "personal" business life. To allow such a fictional dichotomy to have legal effect in a liquidation proceeding would be to give a sole proprietor the legal attributes of a corporation.

On March 15, 1973, the court sustained SIPC's position and held that the 1970 Act does not alter the principles of bankruptcy law as they relate to liquidation proceedings thereunder, that Robert E. Wick must accept the liability which the bankruptcy laws attach to the business form of a sole proprietor-ship, and that the trustee must deal with both the business and personal assets of Robert E. Wick in accordance with the bankruptcy laws.

The former principals of two broker-dealer firms presently being liquidated under the provisions of the 1970 Act are presently serving prison terms for their activities in connection with the operation of their respective businesses.

Robert E. Wick, while conducting a securities business under the name of Robert E. Wick Company, engaged in activities violating the antifraud provisions of the Securities Act of 1933. He pleaded guilty of ten counts of a criminal information charging such violations, and on October 24, 1972, was sentenced to serve eighteen months in a federal penitentiary.

After the Securities and Exchange Commission had obtained an injunction prohibiting the firm of Alan F. Hughes, Inc., and Alan F. Hughes, its controlling person, from violating certain net capital, record keeping, and antifraud provisions of the federal securities laws, Alan F. Hughes continued to solicit and execute securities transactions. Hughes pleaded guilty to charges of criminal contempt based on his wilful violations of that injunction, and on February 2, 1973, was sentenced to six months imprisonment. In imposing sentence, Judge Foley stated:

"[W]hen any investor places his life savings in the hands of stock brokers there has to be a great deal of trust in that kind of individual, and we have to deter not only that individual from doing things that are wrong with small investors' money but also try to deter other people from flouting court orders."

Finally, early in 1973 there were two developments which are worthy of note. On January 19, 1973, the SEC and SIPC commenced an action against Oxford Securities Ltd. The SEC sought to enjoin Oxford from violations of the net capital rule, and SIPC sought an adjudication that the customers of Oxford were in need of the protections of the Act and the appointment of a trustee. Although Oxford consented to the granting of this relief, the district court refused to grant the relief sought by SIPC. The essence of the court's problem revolved around Section 5(b)(3) which provides that if the necessary adjudication is made and a trustee is to be appointed, the court shall appoint the person specified by SIPC if he is disinterested within the meaning of Section 158 of the Bankruptcy Act. The district court was of the opinion that this was an unconstitutional infringement by Congress on the powers of the judiciary. SIPC and the SEC appealed this determination to the U.S. Court of Appeals for the Second Circuit. At the time of oral argument on April 11, 1973, the Court reversed the District Court. Since this decision was announced from the bench it is not known at this time whether an opinion will be issued.

In December, 1972, the application of the trustee for interim allowances in the liquidation of Charisma Securities Corporation (*SIPC* v. *Charisma* Se*curities* Corporation, 72 Civ. 981, SDNY) was denied by the district court. The trustee's application had the concurrence of SIPC. However, the district court was of the view that such an award, in the absence of special circumstances, was premature. This opin-
ion was followed by a decision in the district court for the Eastern District of New York in the liquidation of Quodar Equities, Ltd. (SEC and SIPC v. Quodar Equities, Ltd., 72-C-67, EDNY) which not only reached a result similar to that reached in the Charisma decision but by way of dictum said that "the trustee's fee must be related to the value of the estate." SIPC does not agree that this is the appropriate standard to be used in computing trustees' compensation. However, since the matter involved an interim, as opposed to a final allowance, SIPC and the trustee agreed not to pursue the question at this time but to await the time when application was made for a final allowance. Section 10(b) of the Act provides as follows:

"Engaging in Business After Appointment of Trustee.-It shall be unlawful for any broker or dealer for whom a trustee has been appointed pursuant to this Act to engage thereafter in business as a broker or dealer, unless the Commission otherwise determines in the public interest. The Commission may by order bar or suspend for any period, any officer, director, general partner, owner of 10 per centum or more of the voting securities, or controlling person of any broker or dealer for whom a trustee has been appointed pursuant to this Act from being or becoming associated with a broker or dealer, if after appropriate notice and opportunity for hearing, the Commission shall determine such bar or suspension to be in the public interest.'

In January 1973 SIPC forwarded the names of 191 principals and others associated with 51 firms in liquidation through September 30, 1972 to the SEC for possible action under 10(b). These names were also sent to the various securities exchanges and the NASD for review and the providing of any additional information about these individuals which would assist the SEC in any investigations it may be conducting. Names of principals in more recent cases will be forwarded to the SEC, the securities exchanges, and the NASD after preliminary investigations into the reasons for failure have been completed.

Administrative proceedings taken by the SEC under 10(b) of the Act against Julien M. White and Edward A. White, principals in White & Company, Inc. (St. Louis, Mo.) resulted in both being barred from the securities industry on November 22, 1972.

Investigations are being conducted and, where appropriate, individuals who by irresponsible or criminal acts contributed to the failures are being expelled from the NASD and barred from association with any member and/or barred from the industry by the SEC. The process for review of the facts, marshalling of evidence and application of due process in these cases has been and will continue to be long and tedious. It would be desirable that action be taken promptly as to some of these persons to bar them from the business where this would be appropriate.

In several instances, principals have been indicted and/or convicted of fraud, manipulation or other unlawful acts in criminal actions brought by the regulatory authorities.

ROLE OF SIPC IN RELATION TO CERTAIN FUNCTIONS OF THE SELF-REGULATORY ORGANIZATIONS

One of the purposes of the Act was to achieve, over a period of time, an upgrading of the financial practices and financial responsibility of members of the securities industry. SIPC was intended to participate in this effort in an indirect way, through certain activities outlined in Section 9, in consultation and cooperation with the Securities and Exchange Commission and the self-regulatory organizations.³⁹

Subsection (c) of Section 9 specifies that "if a member of SIPC is a member of more than one self-regulatory organization, SIPC shall designate one of such self-regulatory organizations to inspect or examine such member of SIPC for compliance with applicable financial responsibility rules. Such self-regulatory organization shall be selected by SIPC on the basis of regulatory procedures employed, availability of staff, convenience of location, and such other factors as SIPC may consider appropriate for the protection of customers of its members."

As explained in the first annual report SIPC, in July 1971, wrote to all national securities exchanges and the NASD requesting data concerning the subject matter of Sections 9(c), (d) and (e) of the Act. These materials as received were reviewed and studied in relation to the requirements of the Act, the Commission's rules and SIPC's experience with reporting procedures, and the content of reports received, pursuant to Section 5(a) of the 1970 Act. Where necessary or desirable these data were updated during 1972. In addition, conferences were held with representatives of the exchanges and the NASD as to their procedures and the problems of multiple examinations. Early in 1973 a series of conferences was held as a result of which a proposed program for designating examining authorities in accordance with the scheme of the Act was developed. Among other things an effort was made to achieve a fair regulatory load for each of the organizations consistent with the size of membership and staff. This proposed program was distributed for comment to each exchange, the NASD and the Commission. It is hoped that any difficulties which may arise can be resolved and a definitive proposal submitted to the SIPC Board for formal action in the near future.

The SIPC staff has worked with the staffs of all the self-regulatory organizations in an effort to improve reporting procedures under Section 5(a) and to improve the quality of the financial reports by SIPC member firms primarily from the point of view of an early warning system. This is a continuing function but one which is advisory and cooperative rather than regulatory in nature.

SIPC has not yet had an opportunity to become involved in the complex problems inherent in the development of standards as to method and scope of examinations and reports of such examinations of SIPC member firms by the self-regulatory organizations. All of the self-regulatory organizations have been engaged in programs aimed at strengthening their surveillance systems and a number of attempts have been made by some of them to introduce a greater degree of uniformity in reporting requirements applicable to the member firms.

[&]quot;'Your committee has been concerned about the need for a general upgrading of financial responsibility requirements of broker-dealers, and it recognized this when it stated in its report: 'It is clear that the protections provided by the proposed SIPC fund are really only an interim step. The long-range solution to these problems is going to be found in the ultimate raising of the financial responsibility of the brokerage community' " (Conference Report, December 18, 1970, No. 91-1788, p. 26.)

ADVERTISING OF SIPC MEMBERSHIP AND CUSTOMER PROTECTION

SIPC 11(e) of the 1970 Act provides as follows:

"SIPC shall by bylaw or rule prescribe the manner in which a member of SIPC may display any sign or signs (or include in any advertisement a statement) relating to the protection to customers and their accounts, or any other protections, afforded under this Act. No member may display any such sign, or include in any advertisement any such statement, except in accordance with such bylaws and rules."

In August 1971, after considering various suggestions including those proposed by representatives of the Industry and the fact that all registered broker-dealers and members of national securities exchanges (with limited exclusions heretofore noted) are by law members of SIPC, the Directors determined that advertising of membership in SIPC by SIPC members should not be made mandatory.40 The Board at the same time agreed to adopt as the corporate logotype the symbol which was preferred by a majority of the members of the industry committee. The advertising bylaw became effective in October 1971 and prohibits any advertising of the protection afforded customers by the Act other than by means of the logo or statement authorized by the bylaw.

It was decided, however, that a brochure which had been prepared by SIPC describing SIPC and the 1970 Act would not be considered to be an "advertisement" and, therefore, that distribution of the brochure to customers or other publication of the brochure by SIPC members would not be in contravention of the bylaw. The brochure is viewed as the equivalent of a collection of staff explanations or interpretations with respect to the subjects covered thereby which may be freely distributed by all members of SIPC.

During the development of the brochure, it became apparent that it would be necessary to promulgate rules defining customer "account or accounts" and accounts held by a customer in "separate capacities." These definitions are important in the construction of Section 6(c)(2)(A)(iv) of the 1970 Act relating to the definition of customer's "net equity" and in operation of Section 6(f) of the Act relating to SIPC advances to pay or otherwise satisfy the net equities of customers.

Account rules, designated as the "Series 100 Rules," after submission to the Commission became effective in October, 1971. Shortly thereafter printed copies of a booklet setting forth these rules were distributed to all SIPC members, together with copies of the brochure entitled "An Explanation of the Securities Investor Protection Act of 1970," a one page condensation of the brochure, a foldout setting forth the SIPC bylaw relating to advertising and the SIPC symbol.

Arrangements were made with the National Association of Securities Dealers, Inc. and the Securities Industry Association for SIPC members to purchase these materials as well as signs and posters of various types at prices representing approximate cost.

Copies of the Corporation's first annual report were distributed to all SIPC member firms in May of 1972. Later in the year, in an effort to secure a wide dissemination of information about SIPC and the SIPC program among personnel of member firms, copies of the report were sent to all known branch offices of SIPC members.

In recent months representatives of the Securities Industry Association have proposed that SIPC should modify its position with respect to advertising with a view to permitting the Industry or individual firms to publish advertisements of an institutional character or selected forms having an educational/ informational purpose in order to broaden public understanding of SIPC and the SIPC program. The SIPC Board advised the Association of its willingness to consider proposals along the suggested lines and SIPC is informed that an Industry committee is making progress on such a project.

⁴⁰ The regulations of the FDIC, for example, require FDIC member banks to display an official sign denoting FDIC membership and to include FDIC's official advertising statement or symbol in certain bank advertisements.

REVIEW OF PROPOSALS FOR NEW OR AMENDED RULES AND REGULATIONS OF THE COMMISSION AND OTHERS

A number of rules were adopted by the Commission and the self-regulatory organizations during 1972 which will affect the work of the Corporation. One of the most important developments in the field of broker-dealer financial responsibility occurred on January 15, 1973 when the Commission's new Rule 15c3-3 became effective.

The rule provides a formula for the maintenance by broker-dealers of basic reserves with respect to customers' cash and the cash realized through the utilization of customers' securities and enunciates standards for broker-dealers concerning physical possession or control of fully-paid and excess margin securities of customers. Among other things the rule provides that all fully-paid and excess margin securities in the broker-dealer's physical possession or control or in transfer or stock dividends receivable shall constitute the specifically identifiable property of those customers entitled thereto (by a preponderance of the evidence or other demonstration). The cash or qualified securities in the Reserve Bank Account are determined to be the specifically identifiable property of customers with free credit balances. Subparagraph (d)(2) of the rule provides that the time after which a fail to receive must be reduced to possession through a buy-in or other procedure is 30 days. (Release No. 9856, November 10, 1972)

An amendment to Rule 15b1-2 expanded the prior rule which required persons filing applications to become registered as broker-dealers to furnish verified statements of their financial condition to now require the furnishing of information concerning the adequacy of arrangements that have been made with respect to the personnel, facilities and financing required to operate the business. (Release No. 9594, May 12, 1972)

An amendment to Rule 17a-5 requires brokerdealer firms to report to customers the financial condition of the firm. The rule requires the sending directly to the customer of a broker-dealer certain information which the SEC views as essential to judge whether the broker-dealer is financially sound and additionally requires the furnishing to the SEC of a complete set of financial statements in addition to Form X-17a-5. (Release No. 9658, June 30, 1972.)

An amendment to Rule 17a-5 now requires that each report filed by a broker-dealer pursuant to the rule must be accompanied by a supplemental report on the status of membership of the broker-dealer in SIPC. The supplemental report is to consist of a schedule detailing SIPC assessment payments and overpayments applied or carried forward to future use or, in the alternative, a statement that the broker-dealer is a person not required to be a SIPC member under provisions of the Act. In addition, an independent public accountant's certification must accompany the report, to the effect that the SIPC assessment payments were determined fairly in accordance with applicable instructions and forms or that a claim for exclusion from membership was consistent with income reported. (Release No. 9766, September 15, 1972)

Additional rule changes affecting SIPC in a less direct manner can be found in the following Exchange Act Releases: No. 9587 (amendments to Rule 15c3-1); No. 9734 (an amendment to Rule 17a-3(b)); and No. 9654 (amending Rule 17a-10). In addition to these rule changes, the Commission advised registered broker-dealers of its expanded and intensified inspection and review program and reminded them of their responsibility to comply with the financial record keeping and reporting requirements (Release No. 9468).

A proposed change in the required net capital for broker-dealers, Rule 15c3-1, was published for comment by the Commission on December 5, 1972. The proposed rule would establish a uniform and comprehensive net capital regulation for the entire brokerage industry. It would apply to all brokers and dealers whether or not they are members of registered national securities exchanges. The basic concept of the revised rule is liquidity; that is, a broker or dealer must have at all times sufficient liquid assets to cover his current indebtedness to all persons. The proposed rule is subdivided into four parts: "(1) Classification of Brokers and Dealers for purposes of the minimum liquidity requirements deemed necessary for brokers or dealers who confine their business to various segments of the securities business as well as those who are engaged in a general securities business (i.e. a combination of the various segments) (2) Provisions for exemption from the rule for certain brokers and dealers

and specialists; (3) Standards for purposes of determining liquidity under the rule; and (4) Minimum equity requirements for all brokers and dealers." (See Exchange Act Release No. 9891, December 5, 1972.)

In addition during 1972 a new Rule S6d-1, was published for comment. The comment period expired February 24, 1973. The proposed rule is an exercise of the Commission's rule making power under Section 6(d) of the 1970 Act and was developed pursuant to suggestions by the Corporation. It is designed to permit a trustee to complete open contractual commitments under Section 6(d) of the Act up to a limitation of \$20,000 payable to a brokerdealer for each separate customer's account. The open contractual commitments which may be completed must come within certain time requirements which are designed to close off stale transactions and, further, they must be transactions for which the broker-dealer on the other side acted as agent for a customer. The customer must not be a brokerdealer, a person who had a claim for property that was part of the capital of such broker-dealer or was subordinated to the claims of creditors of such broker-dealer, or a person with a relationship with the debtor or with such broker-dealer as set forth in Section 6(f)(1)(C) of the 1970 Act. Additional details regarding the proposed rule can be found in Release No. SIPA-2, December 21, 1972.

There were a number of procedures adopted by the National Association of Securities Dealers, Inc., in 1972 which affect SIPC. Many of these involve implementation of new Commission rules or rule amendments, such as the monthly filing of a trial balance and supporting schedules by an NASD member for the first year of its operations. In addition the NASD developed a Financial and Operational Comparison Report which it implemented in late 1972. This report is based on quarterly Form "Q" data. Thirty-seven items, both operational and financial, are selected from four consecutive quarterly reports and printed on a comparative basis to reflect the most recent status and any trends which suggest potential problems.

Finally, as indicated in our first annual report,⁴ the Corporation has expressed concern that many brokers do not carry basic fidelity bonds. We have urged the Commission and the NASD to require brokers to obtain blanket fidelity bonding, and we are pleased to note that the membership of the NASD recently approved a proposal which authorizes its Board of Governors to require that NASD members, who are members of SIPC and subject to the SEC net capital rule, obtain such bonds. The proposal would supplement the protections provided by SIPC by covering losses sustained by forgery, misplacement of securities and fraudulent trading. It is anticipated that the NASD will finalize action on this rule in the near future. It is presumed that the Commission will arrange for SECO members to receive equal treatment.

The SIPC staff reviewed drafts of some of the foregoing rule proposals and submitted comments in some instances.

⁴¹ SIPC, First Annual Report, 1971, p. 32.

ADMINISTRATION

Directors

Information concerning the compensation of SIPC's Directors is reflected in the bylaws, which are public documents.

Two directors are employees of their respective government departments or agencies and as such are paid their salaries and expenses by their employers, including those which might be attributable to SIPC. Neither they nor any employees of these agencies receive remuneration or reimbursement from SIPC.

The three industry directors have declined any compensation from SIPC but are reimbursed by SIPC for out-of-pocket expenses in connection with the attendance of Directors' meetings. They have made available to SIPC staff assistance and data from their firms without charge to SIPC in connection with SIPC's consideration of various industry problems. The Vice Chairman of the Board receives \$250 per diem and expenses in connection with attendance of Directors' meetings.

The Chairman of the Board has been serving on a full-time basis as Chief Executive Officer since January 1971 at a salary for the years 1971 and 1972 at an annual rate of \$38,000 plus reimbursement of out-of-pocket expenses when away from Washington on SIPC business. This compensation has been at the rate of \$42,500 per annum effective January 1, 1973.

Personnel

The Vice President-Finance is the principal financial officer of the Corporation. He is a Certified Public Accountant and a former chief examiner of the New York Stock Exchange, Inc. He assumed his position with SIPC on March 15, 1971.

The General Counsel, the principal legal officer of the Corporation, who previously had been associated with the Securities and Exchange Commission, the University of Connecticut and the House Interstate and Foreign Commerce Committee, joined the staff on March 22, 1971.

During the year operational units having particular responsibilities were created or projected. All matters concerned with the collection and recording of assessments and accounting are the responsibility of a unit headed by John B. Bourne, Manager— Accounting and Assessments, a Certified Public Accountant with experience in the securities business.

The financial and operational aspects of the administration of the debtors' estates by the trustees are reviewed by a unit having experience and training in brokerage operations under the direction of Thomas R. Cassella, Manager-Operations and Examination of Liquidations, also a Certified Public Accountant who has had extensive experience in the operations of securities firms. Personnel of the unit review customer claims and accounts in connection with requests by trustees for advances of SIPC funds and in connection with the distribution of cash or securities for the accounts of customers. This staff group lends assistance to trustees, helps coordinate the work of trustees when they have common problems, serves as liaison between trustees and the selfregulatory agencies and, in general, acts as a clearing house where that role is important as it frequently is. Included among this group are investigators who assist in fraud work, such as, tracing customers, detecting multiple accounts, phantom transactions and manipulative activities and, in general, assist the trustees in attempting to eliminate non-bonafide or contrived claims. The indications are that this work will increase and that a heavy burden will continue to be carried by the investigative units of the SEC and the self-regulatory organizations. To the extent that SIPC can assist in this function every effort will be made to do so.

A third unit which will be necessary and as to which a beginning has been made will be charged with developing and maintaining a more complete and accurate record of the surveillance activities of the self-regulatory organizations. This has become a more complex and time-consuming function than had been anticipated and considerable work in this area must be done.

The Corporation has employed an economist who will join the staff in the near future. Among other things he will become deeply involved in the problems confronting SIPC and the Commission concerning varying rates of assessments.

It has become evident that the legal staff must be organized functionally. SIPC has reached a stage where litigation of various types requires an increasing amount of time and personnel. Accordingly, an effort is being made to secure the service of an attorney who can assume responsibilities of this nature.

The growing number of SIPC liquidations has resulted in a substantial increase in the legal work involved in monitoring the cases and assisting the trustees and counsel with various questions arising under the Act and the securities laws generally.

The development and maintenance of an up-todate manual for the use of trustees is an important and continuing activity. The manual attempts to capture the experience of the entire liquidation apparatus with respect to legal and financial questions arising in the cases including pertinent court decisions for the benefit of trustees and their staffs as well as SIPC and its staff as the SIPC program proceeds.

Finally, SIPC's work under Section 9 of the Act is just beginning. Staff requirements for these functions are difficult to project and will be governed by events.

On March 31, 1973 the staff consisted of 29 persons. Six were attorneys, 10 have accounting or other financial or investigative backgrounds, 5 of whom had had experience in the operation or liquidation of brokerage firms. The professional personnel have the support of an excellent secretarial and clerical staff. The average employment in 1971 was 9-10 persons and in 1972 was 21-22.

SIPC has attempted to continue the general policy adopted in its first year of operations of providing for only a small specialized permanent staff and employing professional help on a consulting or temporary basis when necessary. It would not be feasible to have a network of offices around the country and, accordingly, SIPC relies on local legal and accounting firms to represent SIPC at distant points when necessary.

During 1972 SIPC adopted an employee benefit and retirement plan for the employees which compares favorably with the United States Government plan. SIPC's salary scale also compares in a general way with the salaries paid by government offices to professional people.

Lease

SIPC has a five-year lease running from September 1971 on approximately 5000 square feet of space in a new building. The office layout was designed to accommodate operations as visualized in mid-1971. At the time these arrangements were made it was contemplated that normal turnover in a commercial building would afford opportunities in normal course to secure additional space if necessary. During 1972 the building was sold to the United States Postal Service which will require the entire building. An additional 2200 square feet was made available for one year ending October 31, 1973. As of the present time all SIPC space is fully occupied. During the year, therefore, SIPC will require additional space to provide for personnel already required and committed for and to replace the area now under lease which will expire in a few months. A survey is now in progress to determine what facilities may be available.

SIPC Expenses

Total expenses of the Corporation from December 30, 1970 (inception) through December 31, 1972 amounted to \$2,046,469 exclusive of provision for possible losses on advances to trustees. Of the \$2,046,469, commitment fees for the confirmed line of credit aggregated \$528,750 and all other expenses aggregated \$1,517,719. The interest earned on U. S. Government obligations during this same period amounted to \$2,164,299. Appendix III shows detailed classifications of expenses during 1971 and 1972.

FINANCIAL STATEMENTS

LYBRAND, ROSS BROS. & MONTGOMERY

The Board of Directors

Securities Investor Protection Corporation

We have examined the statement of financial condition of Securities Investor Protection Corporation as of December 31, 1972, and the related statements of operations and fund balance and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. We previously examined and reported upon the financial statements for the period December 30, 1970 (inception date) to December 31, 1971.

As explained in Note 5, no provision for liquidation costs to be incurred in subsequent years on liquidations commenced under the Act is determinable, and consequently, it has not been recorded.

In our opinion, except for the matter discussed above, the aforementioned financial statements present fairly the financial position of Securities Investor Protection Corporation at December 31, 1972 and 1971 and the results of its operations and changes in financial position for the year ended December 31, 1972 and for the period December 30, 1970 (inception date) to December 31, 1971, in conformity with generally accepted accounting principles applied on a consistent basis.

Lybrand, Ross Bros. & Montgomery

New York, New York February 27, 1973.

SECURITIES INVESTOR PROTECTION CORPORATION STATEMENT OF FINANCIAL CONDITION December 31, 1972 and 1971

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December 31, 1972 and 1971		
	1972	1971
ASSETS		
Cash:		
Operating and collection accounts	\$ 19,954	\$ 152,834
Compensating balances (Note 2)	5,500,000	6,500,000
	5,519,954	6,652,834
Estimated member assessments receivable (Note 3)	7,310,000	5,710,000
U. S. Government obligations, at amortized cost and accrued interest		
receivable (1972—\$189,837, 1971—None); approximate market		
(1972—\$44,376,212, 1971—\$19,878,484)	44,458,298	19,852,060
Furniture, equipment and leasehold improvements, at cost, less accumu-	70.007	40 472
lated depreciation and amortization (1972—\$12,471, 1971—\$1,548)	76,027	40,472
Advances to trustees, less provision for possible losses (1972-		
\$8,584,684, 1971—\$475,800) (Note 5)	1,219	1,018
Other		
	\$57,365,498	\$32,256,384
LIABILITIES AND FUND BALANCE		
Advances to trustees—in process (Note 5)	\$ 579,659	\$ 286,007
Accounts payable and accrued expenses	130,343	69,781
	710,002	355,788
Commitments (Note 5)		
Fund balance	56,655,496	31,900,596
	\$57,365,498	\$32,256,384
STATEMENT OF OPERATIONS AND FUND BA		
for the year ended December 31, 1972 and the		
from December 30, 1970 (inception) through Decemb		
Revenues:		
Member assessments (Note 3)	\$32,332,156	\$29,778, 2 69
Contribution from a prior trust (Note 4)		3,011,925
Interest on U.S. Government obligations	1,674,257	490,042
5	34,006,413	33,280,236
Expenses:		
Administrative:		
Salaries and employee benefits	477,462	189,878
Assessment collection direct costs	24,047	35,780
Credit agreement commitment fee (Note 2)	292,223	236,527
Legal fees	76.574	70,987

Contribution from a prior trust (Note 4)		3,011,925
Interest on U.S. Government obligations	1,674,257	490,042
	34,006,413	33,280,236
Expenses:		
Administrative:		
Salaries and employee benefits	477,462	189,878
Assessment collection direct costs	24,047	35,780
Credit agreement commitment fee (Note 2)	292,223	236,527
Legal fees	76,574	70,987
Accounting fees	70,169	22,074
Other	202,154	64,634
	1,142,629	619,880
Preparation costs related to potential major liquidations		156,328
Start-up expense—attorneys' and accountants' fees and printing ex-		
pense related to credit agreement and assessment procedures		127,632
Provision for possible losses on advances to trustees (Note 5)	8,108,884	475,800
	9,251,513	1,379,640
Excess of revenues over expenses	24,754,900	31,900,596
Fund balance, beginning of period	31,900,596	
Fund balance, end of period	\$56,655,496	\$31,900,596
The accompanying notes are an integral part of the financ	ial statements	

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STATEMENT OF CHANGES IN FINANCIAL POSITION

for the year ended December 31, 1972 and the period

from December 30, 1970 (inception) through December 31, 1971

	1972	1971
Source of funds:		
Excess of revenues over expenses	\$24,754,900	\$31,900,596
Provision for possible losses on advances to trustees	8,108,884	475,800
Provision for amortization and depreciation	10,923	1,548
	32,874,707	32,377,944
Increases in:		
Advances to trustees in process	293,652	286,007
Accounts payable and accrued expenses	60,562	69,781
Total funds provided	33,228,921	32,733,732
Application of funds:		
Increases in:		
Estimated member assessments	1,600,000	5,710,000
U. S. Government obligations (net) and accrued interest	24,606,238	19,852,060
Furniture, equipment and leasehold improvements	46,478	42,020
Advances to trustees	8,108,884	475,800
Other	201	1,018
Total funds applied	34,361,801	26,080,898
Increase (decrease) in cash	(1,132,880)	6,652,834
Cash, beginning of period	6,652,834	_
Cash, end of period	\$ 5,519,954	\$ 6,652,834

The accompanying notes are an integral part of the financial statements

NOTES TO FINANCIAL STATEMENTS

1. Organization

The Securities Investor Protection Corporation (SIPC) was created by an Act of Congress on December 30, 1970, for the purpose of providing protection to customers of brokers or dealers. SIPC is a non-profit membership corporation and shall have succession until dissolved by an Act of Congress. Its members include all persons registered as brokers or dealers under section 15(b) of the Securities Exchange Act of 1934 and all persons who are members of a national securities exchange except for those persons excluded under the Act.

2. Lines of credit

Under a provision of the 1970 Act, SIPC entered into an agreement dated April 14, 1971, and expiring on October 13, 1976, with certain banks which extended confirmed lines of credit in an aggregate amount of \$65,000,000. A 10/65th portion of the original commitment, to the extent not theretofore availed of, expires annually on the anniversary date, commencing with the year 1972. Accordingly, at December 31, 1972 SIPC has confirmed lines of credit with banks in an aggregate amount of \$55,-000,000. The Act requires a phase out of confirmed lines of credit when the balance of the SIPC fund (as defined by the Act) aggregates \$150,000,000.

Pursuant to the April 14, 1971 agreement, SIPC has agreed to maintain compensating cash balances equal to 10% of the confirmed lines of credit and to pay a fee of $\frac{1}{2}$ of 1% per annum on the average daily unused portion thereof to each bank.

In the event that the SIPC fund is or may reasonably appear to be insufficient for the purposes of the Act, the Securities and Exchange Commission is authorized to make loans to SIPC and, in that connection, the Commission is authorized to issue to the Secretary of the Treasury, notes or other obligations in an aggregate amount not to exceed \$1,000,000,000.

3. Member assessments receivable and assessment revenues

The Act imposed an initial assessment of $\frac{1}{8}$ of 1% per annum on each member's 1969 gross revenues from the securities business as defined in the Act, payable within 120 days of enactment date. Such initial assessments aggregated \$5,669,180 and are included as revenue in 1971.

Annual general assessments imposed for 1971 and thereafter, are payable quarterly at the rate of $\frac{1}{2}$ of 1% per annum on gross revenues from the securities business. SIPC members are allowed to make estimated quarterly payments based upon the previous year's gross revenues. Annual general assessment reconciliation forms must be filed and underpayments for any year are due within 120 days after December 31. Overpayments for any year may be credited against future assessments.

Member assessments receivable at December 31. 1971 are based upon collections received through February 29, 1972, and do not include any additional amounts due by May 1, 1972. Effective January 1, 1972, SIPC changed its method of accruing member assessments revenue from the method described above to a method whereby member assessments receivable at December 31, 1972 are based on estimated gross revenues of members for the year **1972.** This change resulted in an additional accrual of \$540,000 for 1972. Had the method of accruing assessments at December 31, 1972 been in effect at December 31, 1971, the "Estimated member assessments receivable" and the "Member assessments" and "Excess of revenues over expenses" and "Fund balance" in the accompanying financial statements for 1971 would have been increased by \$4,143,321, and the "Member assessments," "Excess of revenues over expenses" and "Fund balance beginning of period" for 1972 would have been reduced by \$4,143,321.

The following table reflects pro forma amounts in the statement of operations and fund balance, had the method used in 1972 also been used in 1971:

	1972	1971
Member assessments:		
Initial		\$ 5,669,180
General	\$28,188,835	28,252,410
	\$28,188,835	\$33,921,590
Excess of revenues		
over expenses	\$20,611,579	\$36,043,917
Fund balance	\$56,655,496	\$36,043,917
		-

4. Contribution from a prior trust

In 1971, \$3,011,925 was contributed from a special trust fund of the American Stock Exchange, Inc., members of which shall be entitled to a reduction in amounts payable on future assessments, as provided in the Act. The Board of Directors has not determined when and on what basis such reductions may be made.

5. Advances to trustees and commitments

Trustees had been appointed under the Act for twenty-four SIPC member firms as of December 31, 1971. During 1972, trustees were appointed to liquidate an additional 40 SIPC member firms. Because of inadequate and incomplete books and records of many of these firms, data presently available from the Trustees are inconclusive and no determination of the ultimate amounts which may be required for advances to satisfy customer claims, nor the liquidation expenses which will be incurred, is possible at this time.

The amounts advanced in connection with these liquidations represent net amounts disbursed and accrued. SIPC has adopted the policy of providing a 100% reserve for all advances to Trustees. Amounts of unexpended advances, as well as any expended advances for which SIPC has subrogated rights, which may be recovered by the Trustees through legal proceedings, are returnable to SIPC and are applied upon receipt as a reduction of the advances to trustees and the provision for possible losses on advances. Amounts which subsequently may be returned are not presently determinable.

6. Retirement Plan

Effective July 1, 1972 SIPC adopted a voluntary, contributory retirement plan for employees. SIPC's policy is to fund pension expense. Pension expense for 1972 was \$43,400, including all prior service costs which approximate \$25,000.

PART A: Customer Claims and Distributions Being Processed by Trustees

Company and trustee by date of appointment	Date regis- tered as Broker-Dealer	Initial Capital	Filing Date*	Trustee Appointed	Customers*** to whom Notices and claim forms were mailed	Number of Customer Claims Received
Third Quarter 1971						
**Security Planners, Ltd. Boston, Massachusetts (William C. Foehl, Esq.)	2/12/68	\$ 45,000	3/18/71	8/ 6/71	50	30
Fourth Quarter 1971						
**Financial Equities, Ltd. Los Angeles, California (Gilbert Robinson, Esq.)	3/26/70	217,004	9/17/71	11/ 8/71	4,000	546
International Funding Securities, Inc. Long Beach, California (Sheldon Jaffe, Esq.)	3/31/62	32,988	6/ 3/71	12/ 6/71	12,000	950
**E. P. Seggos & Co., Inc. New York, New York (Clark J. Gurney, Esq.)	2/ 6/70	250,000	12/13/71	12/14/71	450	250
First Quarter 1972						
S. J. Salmon & Co., Inc. New York, New York (John C. Fontaine, Esq.)	8/17/68	10,000	2/ 7/72	2/ 7/72	4,945	1,873
**C. H. Wagner & Co., Inc. Boston, Massachusetts (Thomas J. Carens, Esq.)	6/23/69	20,500	2/22/72	2/28/72	14,000	181
**J. R. Radin & Co., Inc. New York, New York (William W. Golub, Esq.)	3/30/70	78,000	3/ 9/72	3/ 9/72	1,190	390
White and Co. St. Louis, Missouri (Hugh S. Hauck)	3/ 5/47	N/A	3/23/72	3/30/72	50	41
Second Quarter 1972						
**Parker, England & Co., Inc. Hicksville, New York (John R. Dunne, Esq.)	10/23/68	8,000	11/12/71	4/20/72	600	325
John E. Samuel & Co. White Plains, New York (Henry J. Smith, Esq.)	5/ 9/62	25,000	2/ 3/72	5/30/72	350	10
**Maurice Timothy Sullivan d/b/a M. Timothy Sullivan Boston, Massachusetts (Michael M. Marx)	7/23/59	18,415	6/12/72	6/12/72	104	39

*See Page 19 for definition of Filing Date

**Distributions to Customers Substantially Completed as of March 15, 1973

***Trustees mail claim forms to all persons whose names and addresses appear in the debtors' records whether or not the records show securities positions and/or money balances.

	tions of Pro	pertie			_						
Specif Identi	fically ifiable		Sing Separ	gle and ate Fund			SIPC Advances to Trustees				
Value	Number Customer	s	Value	Number Customers	- Total Advanced	Administration Expenses	Open Contractual Commitments	Cash in Lieu of Securities	Free Credit Balances	Number of Customers	
					\$ 36,495		:	\$ 36,111	\$ 384	30	
\$ 116,058	314				34,940				34,940	117	
4,000	12				217,463	\$ 53,758		81,528	82,177	129	
53,100	145	\$	92,000	141	19,718	2,500		16,106	1,112	12	
1,943,112	1,360				573,144	132,000			441,144	371	
54,889	8				1,052,893	10,015		67,846	975,032	182	
207,000	214				49,500	100			49,400	55	
2,229	1				153,226	4,878		143,183	5,165	14	
9,004	14		68,754	134	19,959	1,432		7,220	11,307	68	
			10,000	1							
					500	500					

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PART A: Customer Claims and Distributions Being Processed by Trustees

Company and trustee by date of appointment	Date regis- tered as Broker-Dealer	Initial Capital	Filing Date	Trustee Appointed	Customers to whom Notices and claim forms were mailed	Number of Customer Claims Received
Third Quarter 1972						
Centaur Securities, Ltd. Salt Lake City, Utah (D. Spencer Nilson)	9/14/70	\$ 21,000	7/14/72	7/17/72	2,000	356
G. M. Stanley & Co., Inc. New York, New York (Winthrop J. Allegaert, Esq.	4/11/69)	45,000	7/17/72	7/18/72	1,044	330
Holt, Murdock Securities, Inc. Helena, Montana (Thomas F. Dowling, Esq.)	11/10/70	50,550	7/26/72	7/26/72	650	180
North American Planning Corporation New York, New York (Joseph D. Ellison)	4/ 9/70	113,000	7/25/72	8/ 8/72	2,700	918
Kenneth Bove & Co., Inc. New York, New York (William W. Golub, Esq.)	5/17/66	6,000	5/25/72	8/17/72	12,500	6,300
Northeast Investors Planning Corporation Bronx, New York (David Handel)	12/22/69	10,000	8/21/72	8/23/72	1,050	300
**Doores Securities Corp. New York, New York (Peter H. Morrison, Esq.)	4/ 9/70	27,000	8/25/72	8/31/72	185	25
**King Securities of Chicago, Incorporated Chicago, Illinois (J. Kirk Windle, Esq.)	9/29/71	10,000	9/14/72	9/15/72	50	20
Fourth Quarter 1972						
**Trio Securities, Inc. New York, New York (Bernard L. Augen)	5/20/71	7,500	9/29/72	10/ 3/72	72	71
G. L. Equities Corporation New York, New York (Charles H. Kaufman)	12/10/69	7,000	9/14/72	10/11/72	537	245
Equitable Equities, Inc. New York, New York (Herbert S. Camitta, Esq.)	2/ 4/70	76,570	10/13/72	10/13/72	134	69
Bovers, Parnass & Turel, Inc. Jersey City, New Jersey (Edward J. Rosner, Esq.)	10/12/68	10,000	10/19/72	10/19/72	1,180	300
Albert & Maguire Securities Co., Inc. Philadelphia, Pennsylvania (Donald M. Collins, Esq.)	9/ 9/68	26,200	10/19/72	10/19/72	5,181	1,316

	Specit Identi	Specifically Single and Identifiable Separate Fund				, <u>, , , , , , , , , , , , , , , , , , </u>				
	Value	Number Customers	Value	Number Customers	Total Advanced	Administration Expenses	Open Contractual Commitments	Cash in Lieu of Securities	Free Credit Balances	Number of Customer
6	38,530	117			\$ 17,535				\$ 17,535	113
	42,739	104			13,997	\$ 13,997				
					5,588	5,588				
	366,476	322			99,918	25,035		\$ 6,608	68,275	5
	284,114	423			566,400	100			566,300	1,76
					2,500	2,500				
					3,129	3,129				
					150	150				

12,439 12,439

APPENDIX I

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PART A: Customer Claims and Distributions Being Processed by Trustees

Company and trustee by date of appointment	Date regis- tered as Broker-Dealer	Initial Capital	Filing Date	Trustee Appointed	Customers to whom Notices and claim forms were mailed	Number of Customer Claims Received
Fourth Quarter 1972 (con	itinued)					
Havener Securities Corp. New York, New York (Ezra G. Levin, Esq.)	11/13/59	\$ 32,800	10/13/72	10/24/72	900	461
C. I. Oren & Co., Inc. New York, New York (Martin R. Gold, Esq.)	11/10/68	100,000	10/13/72	10/26/72	345	20
**J. R. Narwitz & Co. Sacramento, California (Loren S. Dahl, Esq.)	11/19/67	146,218	11/ 8/72	11/ 8/72	1,000	20
Comstock Securities, Ltd. Salt Lake City, Utah (Herschel J. Saperstein, Es	8/24/71 	25,000	11/20/72	11/20/72	350	-
First Midwest Investment Corporation Milwaukee, Wisconsin (Frank C. Verbest)	8/ 1/68	12,100	11/28/72	11/28/72	2,500	600
Horizon Securities, Inc. New York, New York (Alan Palwick, Esq.)	6/ 4/70	7,578	12/ 1/72	12/ 1/72	1,050	269
First Eastern Investment Corporation Red Bank, New Jersey (Burton Peskin, Esq.)	1/29/58	29,000	12/11/72	12/11/72	700	60
Project Securities & Co., Inc. Union, New Jersey (Martin D. Moroney, Esq.)	4/15/70	29,256	12/13/72	12/13/72	1,230	25
TOTALS PART A:					73,097	16,520

Distributions of Properties held by Trustees

Specifically Identifiable			gle and			SIPC Advances	to Trustees		
Value	Number Customers	Value	rate Fund Number Customers	Total Advanced	Administration Expenses	Open Contractual Commitments	Cash in Lieu of Securities	Free Credit Balances	Number of Customers

\$ 3,000 \$ 3,000

¢2 1 21 251	2 0 2 1	\$ 170,754	276	\$2,882,494	¢071 101	\$ 358,602	\$0 050 771	2,907
φ3,1Z1,Z31	3,034	φ 170,754	270	φ <i>2</i> ,002,494	φζ/Ι,ΙζΙ	φ 550,002	ΨΖ,ΖϽΖ,//Ι	2,907
				<u> </u>				

PART B: Substantially All Customer Claims (Except Problem Claims) Have Been Satisfied

Company and trustee by date of appointment	Date regis- tered as Broker-Dealer	Initial Capital	Filing Date	Trustee Appointed	Customers to whom Notices and claim forms were mailed	Number of Customer Claims Received
First Quarter 1971						
Orin R. Dudley d/b/a Orin R. Dudley Co. New York, New York (J. Lincoln Morris, Esq.)	12/12/63	\$ 26,210	2/18/71	3/29/71	1,250	128 9
Second Quarter 1971						
Howard Carlton, Inc. New York, New York (Clark J. Gurney, Esq.)	5/31/69	5,000	2/ 1/71	4/ 8/71	350	122
Joseph Garofalo d/b/a Josephson Company New York, New York (Sidney H. Leeds)	12/ 8/68	10,500	3/ 5/71	4/23/71	550	32
Stan Ingram & Associates Los Angeles, California (Harold L. Orchid, Esq.)	12/22/68	19,871	2/22/71	6/ 8/71	400	41
First Investment Savings Corporation Birmingham, Alabama (William Green, Esq.)	3/16/56	9,137	6/17/71	6/18/71	204	196
Packer, Wilbur & Co., Inc. New York, New York (Martin R. Gold, Esq.)	6/22/61	9,000	3/25/71	6/21/71	475	238
PLM Securities, Inc. Syracuse, New York (Howard A. Port)	8/ 9/67	25,000	4/ 7/71	6/28/71	900	44
Third Quarter 1971						
John, Edward & Co., Inc. Lebanon, New Hampshire (George L. Manias, Esq.)	1/17/68	48,500	3/ 5/71	7/ 1/71	1,800	181
Karle R. Berglund d/b/a Colonial Investment Securities Worcester, Massachusetts (Gordon A. Martin, Esq.)	12/13/68	20,173	1/12/71	8/ 6/71	48	22
Barnes, Ryder, Waddles and Co., Inc. Wichita, Kansas (Thomas R. Brunner)	11/13/69	42,270	6/25/71	8/18/71	2,782	1,175
Securities Brokers Associates Inc.	, 2/26/69	88,400	8/13/71	8/20/71	42	42
Securities Brokers Investment Inc. Fort Lauderdale, Florida (Carmen A. Accordino, Esq.	3/26/70	25,000				

	Distribu	itions of Prop	perties held by Tr	rustees	_					
-	Speci	fically ifiable	Sing	gle and ate Fund	-		SIPC Advances	to Trustees		
-	Value	Number Customers		Number Customers	Total Advanced	Administration Expenses	Open Contractual Commitments	Cash in Lieu of Securities	Free Credit Balances	Number of Customers
\$	112,296	75	\$ 2,194	1	\$ 249,120	\$ 33,057		\$ 177,405	\$ 38,658	36
	157,300	44			17,110	5,119	\$ 8,225	251	3,515	9
					64,288	322		36,192	27,774	37
	3,293	9	500	2	42,452			33,382	9,070	35
	81,574	184			52,865	19,403	2,380	478	30,604	47
	12,350	37			305,262	30,562		174,751	99,949	155
	6,902	5			29,872			29,521	351	22
	1,484	2	10,270	12	90,289	17,458		14,382	58,449	73
	11,500	9			39,790	19,802			19,988	5
	185,626	206	296,744	718	276,857			226,100	50,757	534
ĺ			16,265	11	144,991			127,783	17,208	34

Distributions of Properties held by Trustees

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PART B: Substantially All Customer Claims (Except Problem Claims) Have Been Satisfied

Company and trustee by date of appointment	Date regis- tered as Broker-Dealer	Initial Capital	Filing Date	Trustee Appointed	Customers to whom Notices and claim forms were mailed	Number of Customer Claims Received	-
Third Quarter 1971 (conti	nued)						
Lang-Lasser & Co., Inc. Beverly Hills, California (Kevin O. Lewand, Esq.)	1/30/70	\$ 63,116	6/ 8/71	9/14/71	200	6	
Fourth Quarter 1971							L
Far Western Securities, Inc. Tucson, Arizona (Thomas A. Latta, Esq.)	4/15/70	56,750	8/26/71	10/13/71	453	64	\$
Buttonwood Securities, Inc. LaJolla, California (Edwin M. Lamb)	2/27/69	60,500	9/ 8/71	10/18/71	3,780	1,502	
Commonwealth Securities Corporation Nashville, Tennessee (Fred D. Bryan)	12/ 1/62	10,312	8/25/71	10/22/71	4,100	319	
Aberdeen Securities Co., Inc. Wilmington, Delaware (Claude P. Hudson)	5/14/69	26,000	9/15/71	11/22/71	1,800	281	
Baron & Co., Inc. Jersey City, New Jersey (Mark F. Hughes, Jr., Esq.)	9/26/69	10,000	11/22/71	12/ 1/71	275	183	l
Rodney B. Price & Co., Inc. Atlanta, Georgia (Robert E. Hicks, Esq.)	4/29/70	31,755	12/ 7/71	12/ 7/71	891	59	
Securities Northwest, Inc. Seattle, Washington (George M. McBroom, Esq.)	6/23/71	5,000	12/ 7/71	12/ 7/71	940	117	l
Kelly, Andrews & Bradley, Inc. New York, New York (Edwin L. Gasperini, Esq.)	8/10/68	5,000	12/15/71	12/21/71	1,327	205	
First Quarter 1972			•				l
Mid-Continent Securities Co., Inc. Wichita, Kansas (Thomas R. Brunner)	12/13/50	20,000	1/ 3/72	1/ 3/72	1,191	588	l
F. O. Baroff Company, Inc. New York, New York (Edward S. Davis, Esq.)	10/29/66	19,679	1/ 6/72	1/ 6/72	4,225	1,591	
Alan F. Hughes, Inc. Schenectady, New York (William J. Quinlan, Esq.)	12/ 9/65	9,001	8/18/71	1/17/72	664	251	
A. H. Simon Securities New York, New York (Winthrop J. Allegaert, Esq.)	9/14/70	12,575	1/17/72	1/17/72	94	45	

Distributions of Properties held by Trustees				rustees	_										
Speci	ificall y ifiable		Sing Separ	gle and ate Fund			SIPC Advances								
Value	Number Custome	rs	Value	Number Customers	- Total Advanced	Administration Expenses	Open Contractual Commitments	Cash in Lieu of Securities	Free Credit Balances	Number of Customers					
					\$ 31,669	\$ 9,291		\$ 22,378		5					
\$ 3,557	23	\$	57	1	15,762			15,246	\$ 516	5 45					
680,706	643		251,928	535	341,825	196,505		57,621	87,699) 331					
5,683	15		5,425	54	56,746	4,802		38,964	12,980) 152					
13,013	33		40,558	107	115,325		\$ 23,022	75,301	17,002	2 158					
65,605	124		7,563	51	29,939				29,939	9 76					
29,100	10		5,846	28	23,353			10,113	13,240) 29					
69,581	18		23,116	7	66,856		31,823	1,875	33,158	3 47					
23,050	54		13,249	34	136,664	69,616		12,663	54,385	5 55					
93,215	126		51,231	329	889,142	50		752,457	136,635	5 353					
1,275,540	1,205				1,046,584		112,989	718,820	214,775	5 1,224					
164,711	70		94,282	5	307,866	25,038		273,580	9,248	3 58					
27,355	37		16,713	15	39,818	10,137		12,995	16,686	5 21					

Distributio of Dr parties held by Trust

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APPENDIX I

PART B: Substantially All Customer Claims (Except Problem Claims) Have Been Satisfied

							-
Company and trustee by date of appointment	Date regis- tered as Broker-Dealer	Initial Capital	Filing Date	Trustee Appointed	Customers to whom Notices and claim forms were mailed	Number of Customer Claims Received	ŕ -
First Quarter 1972 (contin	nued)						
Quodar Equities, Ltd. Great Neck, New York (Edward J. Rosner, Esq.)	12/30/70	\$ 28,055	1/14/72	1/21/72	804	165	\$
Murray, Lind & Co., Inc. Jersey City, New Jersey (Mark F. Hughes, Jr., Esq	5/23/69 q.)	227,215	1/14/72	1/24/72	1,186	749	
JNT Investors, Inc. New York, New York (Jerry B. Klein)	6/17/70	35,000	2/15/72	2/15/72	1,572	938	
Charisma Securities Corp. New York, New York (Edwin L. Gasperini, Esq.)	7/ 4/69	19,115	3/ 8/72	3/ 9/72	804	34	
First Continental Securities, Inc. Dallas, Texas (Theodore Mack, Esq.) (Suc cessor Trustee)	12/ 2/64 c-	4,002	3/14/72	3/14/72 7/18/72	125	33	
Robert E. Wick d/b/a/ Robert E. Wick Company Oak Park, Illinois (J. Kirk Windle, Esq.)	1/15/70	62,751	3/14/72	3/14/72	49	22	
Barrett & Company, Inc. Minneapolis, Minnesota (Lawrence Perlman, Esq.)	5/17/71	30,867	3/29/72	3/29/72	558	321	
Second Quarter 1972							
Marrocco & Co., Inc. Brookline, Massachusetts (Michael M. Marx)	9/ 9/70	15,000	3/23/72	3/30/72	457	45	
TOTAL Part B					34,296	9,739	144
SUMMARY PART A and PART	T B FOR 64 FII	RMS IN LIQU	IDATION AS	AT DECEMBI	ER 31, 1972		
			RMS PART A RMS PART B		73,097 34,296 107,393	16,520 9,739 26,259	IT 40 I
A REAL PROPERTY AND A REAL							

GENERAL NOTES:

The books and records of the debtors being liquidated are generally found by the Trustee to be (1) not up to date, (2) incomplete, (3) irreconcilable, (4) non-existent, or a combination of these. Construction of the necessary financial data is proving to be a task of major proportions and a cause of considerable administrative expense.
 Based upon claims received to date, Trustees have reported the following number of claims that exceeded the \$50,000/\$20,000 limitations provided in the Act:

	No. of claims reported		
Claims for free credit balances Claims for securities	14 9	Amount in excess of limit for cash Amount in excess of limit for securities	\$235,246 283,509
			\$518,755

Distribu		peru	es neid by n	uslees											
Specifically Single and Identifiable Separate Fund			_	SIPC Advances to Trustees											
Value	Number Customer		Value	Number Customers		Total Advanced	Adr E	ninistration Expenses	Co Con	Open Intractual Inmitments		Cash in Lieu of Securities	B	Free Credit alances	Number of Customers
\$ 2,665	8				\$	\$ 130,783	\$	5,737			\$	45,213	\$	79,833	90
250,350	296	\$	225,125	392		120,435		21,359	\$	4,426		21,950		72,700	302
1,597,598	823		150,979	140		186,947		52,823				22,989		111,135	83
						33,013		11,947				1,360		19,706	20
8,373	9					8,913						6,581		2,332	16
						147,123		2,987				131,283		12,853	22
97,316	151		86,989	227		71,668		13,580				54,713		3,375	5 138
160	2					9,204	\$	2,500				6,237		467	' 15
\$4,979,903	4,218	\$1	,299,034	2,669	\$	5,122,531	\$!	552,095	\$1	82,865	\$	3,102,584	\$1,	284,987	4,227
3,121,251 4,979,903 \$8,101,154	3,034 4,218 7,252		170,754 1,299,034 1,469,788	276 2,669 2,945	4	2,882,494 5,122,531 \$8,005,025		271,121 552,095 323,216	-	.82,865		358,602 3,102,584 3,461,186	1,	252,771 284,987 537,758	4,227

REASONS FOR FAILURES OF BROKER-DEALER FIRMS IN LIQUIDATION UNDER THE 1970 ACT

Illustrative examples . . .

- —Bank demand for repayment of loan collateralized by speculative securities which declined drastically in value . . Questionable trades executed by firm's trader.
- —Chronic operating deficit which firm could not cover by infusion of additional capital . . . Fraudulent withdrawal of capital by a principal . . . Inexperienced management . . . Excessive trading in highly volatile securities.
- ---Overexpansion from a limited capital base . . . Serious deficiencies in system of accounting and internal control . . . Fraud in settlement of trades.
- -Large losses suffered when foreign customers failed to honor contracts . . . Sale of stolen securities for a customer . . . Undue reliance on subordinated capital.
- ---Reliance upon restricted securities in subordinated capital account . . . Recurrent operating deficits.
- Recurring operating losses . . . Excessive advances to salesmen . . . Loss of control of trading inventory and operations.
- -Rapid expansion into a phase of the business in which principals had no experience . . . Excessive overhead . . . Inept management.
- ---Erosion of capital through excessive and unjustified operating expenses . . . Conversion of customer funds to cover operating costs.
- —Promotion of highly speculative registered and unregistered securities . . . Inexperienced back office staff . . . Mismanagement.
- ---Undue concentration of securities of doubtful liquidity in trading account . . . Possible fraud in maintenance of customer accounts.
- -Concentration in trading account of one issue which was suspended from trading.
- ---Expiration of subordination agreement . . . Excessive operating costs . . . Lack of supervision and control.

- Inept management . . . Misappropriation of subordinated capital . . . Fraudulent transactions in customer accounts . . . Disallowance of asset value for trading inventory.
- Capital insufficient to support expanded operations . . Books inaccurate and not properly maintained.
- ---Marginal capital . . . Inexperienced principals . . . Fraud and conversion of customer funds . . . Inaccurate and incomplete books and records.
- -Assumption of the liabilities of a predecessor firm on limited capital . . . Inability to operate profitably.
- —Fraud and deception by an employee . . . Failure to supervise . . . Losses in trading account . . . Excessive overhead.
- Large short position in a highly volatile security which firm was not able to cover . . . Inaccurate books and records.
- —Conduct of an OTC trading business for which principals were totally unqualified . . . Thin capital base . . . Inadequate and inaccurate books and records.
- —Poor organization . . . Positioning speculative securities in inventory . . . Possible embezzlement . . . Chaotic books and records.
- —Poor internal control . . . Excessive operating costs . . . Fraud and deception of customers . . . Inadequate and inaccurate books and records.
- ---Chronic net capital deficiencies . . . Inadequate system of accounting and internal control . . . Excessive operating costs . . . Adverse market conditions.
- Total reliance upon subordinated capital . . .
 Overconcentration in highly volatile securities . . .
 Possible malfeasance . . . Inaccurate books and records.
- ----Inexperienced principals . . . Attempted manipulation which created an unsupportable liability.

- —Marginal capital base for underwriting activities . . . Overconcentration in one security underwritten by the firm . . . Inexperienced principals.
- ----Large inventory in one highly speculative issue which declined precipitiously in a two-day period.
- —Undercapitalization . . . Manipulative practices with inter-related firms . . . Deplorable books and records . . . Lack of supervision and control.
- ---Chronic capital deficiencies . . . Adverse market conditions . . . Inexperienced back office and high turnover . . . Lack of supervision.
- ---Excessive withdrawals by operating principal which depleted capital from inception.
- —Capital inadequate for general securities business . . . Fraud and deception in solicitation of customers and handling of their funds and securities.
- ---Speculative short selling in firm trading account . . . Adverse market conditions.

- Manipulation involving outsider to detriment of firm . . . Misappropriation of customer funds for speculative firm trading . . . Inexperienced principals.
- ---Withdrawal of subordinated capital . . . Unauthorized trades by employee . . . Poor internal control.
- ---Malfeasance and manipulation involving interlocking firms . . . Fraudulent withdrawal of customer funds . . . Falsification of financial status.
- ----Improper hypothecation of customer securities . . . Conversion of customer funds.
- Overexpansion of sales and trading activities . . . Inexperienced principals . . . Inefficient back office . . . Failure to supervise.
- —Losses from underwriting and market-making activities . . Excessive commission payments and excessive overhead incident to branch office operations and commission schedule.
- —Possible fraud in withdrawal of capital from firm . . . Trading in low-priced securities . . . Mismanagement.

ANALYSIS OF SIPC 1972 and 1971 EXPENSES

	1972	1971
dministrative		
Salaries and Employee Benefits		
Salaries	\$ 411,075	\$ 178,036
FICA taxes	10,681	4,509
Federal unemployment tax	567	250
D. C. unemployment tax	3,113	1,298
Group life insurance	3,423	2,943
Group health insurance	2,799	2,842
Contribution to Employees' Retirement Trust	43,400	
Other employee benefits	2,404	
	477,462	189,878
Assessment Collection Direct Costs	24,047	35,780
		236,527
Credit Agreement Commitment Fee	292,223	
Legal Fees	76,574	70,987
Accounting Fees	70,169	22,074
Other Printing and mailing Annual and Quarterly Reports	23,901	
Directors fees and expenses	6,096	8,609
Travel and subsistence	23,981	4,154
Personnel recruitment	5,832	3,790
Rent—office space	34,073	10,849
Depreciation and amortization	10,923	1,548
	3,137	2,549
Postage	3,471	1,069
Office supplies and expense	25,920	13,140
Telephone and telegraph	17,966	4,583
Custodian fees	15,940	4,538
Miscellaneous	30,914	9,805
	202,154	64,634
	1,142,629	619,880
reparation Costs Related to Potential Major Liquidations	1,172,023	
Legal fees		126,528
Accounting fees		29,800
		156,328
tart-Up Expense—Attorneys' and Accountants' Fees and Printing Expense Related to Credit Agreement and Assessment Procedures		
Accounting fees		69,359
Legal fees		48,571
Printing		9,702
		127,632
rovision for Possible Losses on		
Advances to Trustees	8,108,884	475,800
Total	\$9,251,513	\$1,379,640

FORM OF NOTICE ENCLOSED WITH TRUSTEES' CHECKS IN PAYMENT OF CUSTOMERS' CLAIMS



/news-and-media/ in-the-media

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SECURITIES INVESTOR PROTECTION CORPORATION

485 L'ENFANT PLAZA, S.W., WASHINGTON, D.C. 20024