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SECURITIES INVESTOR PROTECTION ACT AMENDMENTS

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HEARING

BEFORE THE

SUBCOMMITTEE ON SECURITIES

OF THE

COMMITTEE ON

BANKING, HOUSING, AND URBAN AFFAIRS

UNITED STATES SENATE

NINETY-FIFTH CONGRESS

SECOND SESSION

ON

H.R. 8331

TO AMEND THE SECURITIES INVESTOR PROTECTION ACT OF 1970

APRIL 25, 1978

Printed for the use of the
Committee on Banking, Housing, and Urban Affairs

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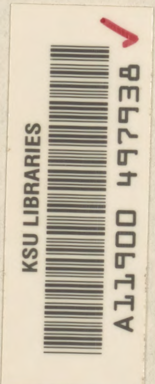

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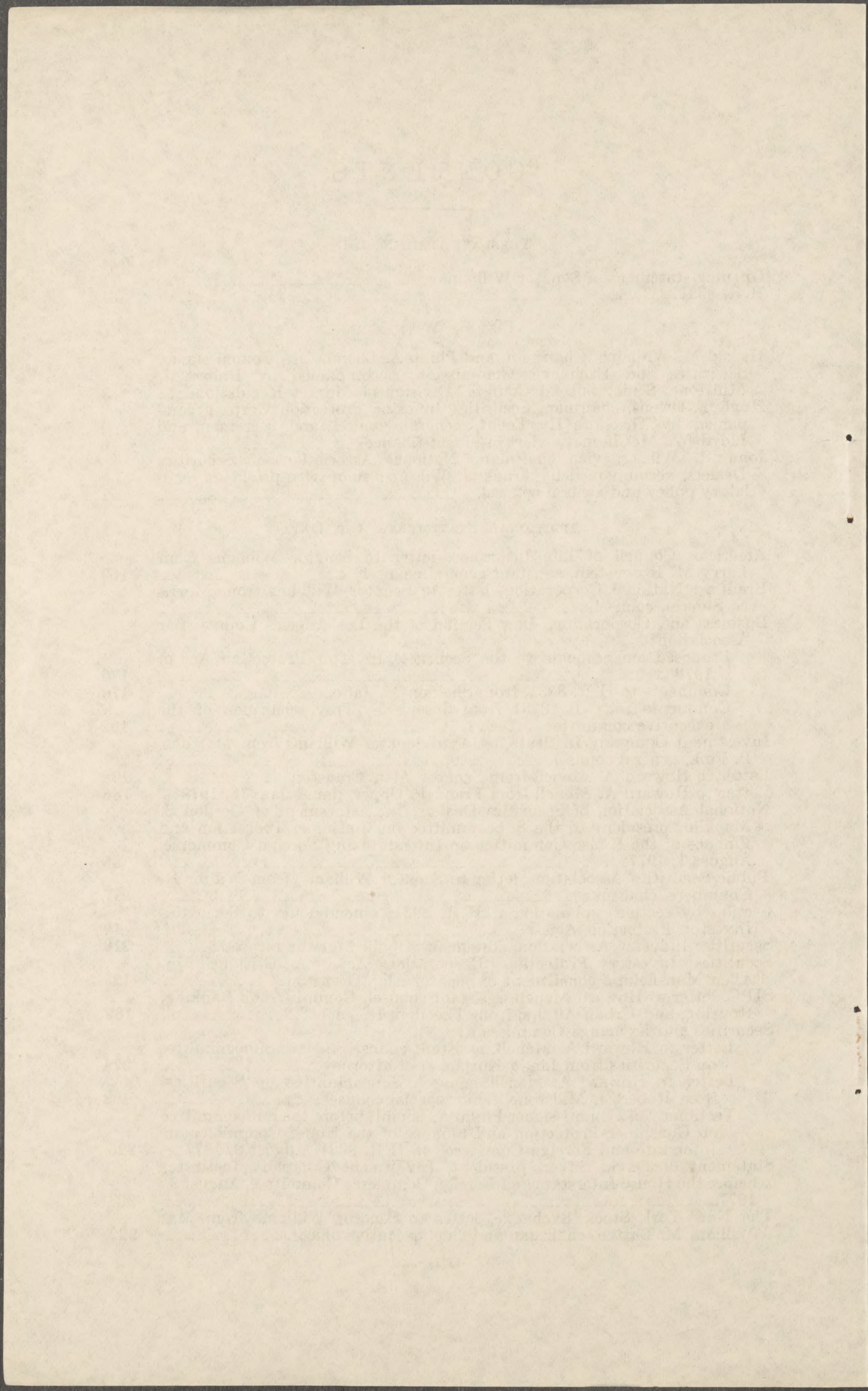

SECURITIES INVESTOR PROTECTION ACT AMENDMENTS

TUESDAY, APRIL 25, 1978

U.S. Senate,
Committee on Banking, Housing, and Urban Affairs,
Subcommittee on Securities,
Washington, D.C.

The subcommittee met at 2 p.m. pursuant to notice, in room 5302, Dirksen Senate Office Building, Senator Harrison A. Williams, Jr. (chairman of the subcommittee) presiding.

Senator Williams. We can now begin our subcommittee hearing.

The Subcommittee on Securities will receive testimony on H.R. 8331, the Securities Investment Protection Act Amendments of 1977.

[The bill is printed at p. 61.]

OPENING STATEMENT OF SENATOR WILLIAMS

Senator Williams. At the very outset I should state that I am very pleased about the bill our counterparts in the House have recommended for the subcommittee's consideration. With the exception of a technical amendment to the title of the bill to reflect the proper calendar year, 1978, I believe an excellent bill has been fashioned. The hearing this afternoon should reinforce my analysis of the bill, that the bill in its present form can be enacted into law with dispatch.

Since the Congress has not revisited or reexamined the Securities Investor Protection Corp. since its creation in 1970, it is necessary first to place this bill in perspective by reviewing briefly the circumstances surrounding SIPC's creation and its experience during the past 8 years.

In the closing days of 1970, the Congress established the Securities Investor Protection Corp. in response to the Wall Street back office crisis and the bear market of the late 1960's. During this turbulent period, a number of brokerage firms went out of business. Their public customers were exposed to serious financial losses and public confidence in the securities markets was badly shaken. To restore public confidence in the securities markets and to protect public investors against the failure and insolvency of brokers and dealers, the Securities Investor Protection Act of 1970 was adopted.

Since that time SIPC has administered 128 broker-dealer liquidations. The value of cash and securities it has distributed for accounts

of more than 105,000 customers exceeds $279 million. Of this amount, approximately $234 million was from debtor estates and $45 million from SIPC advances. In short, SIPC has protected investors against loss in the manner envisioned by its creators and at no cost to the taxpayer.

As my colleagues will recall, SIPC was considered and passed on an emergency basis. The need for prompt action required that certain technical problems relating to the procedures for liquidating securities firms would be left for later solutions in light of actual experience under the new law. At his first confirmation hearing in November 1973, then and still SIPC Chairman Hugh F. Owens advised the committee that SIPC would undertake a thorough study of possible amendments to the SIPC Act.

Pursuant to this commitment, Chairman Owens appointed a broadly based task force to explore better, quicker and more efficient methods of achieving the investor protection and investor confidence envisaged by the Congress when it passed the 1970 act.

The bill before us this afternoon is a direct outgrowth of this effort. While there have been some useful and constructive revisions made to the original SIPC recommendations by the House of Representatives, the basic wisdom and advice from SIPC have been preserved almost completely intact.

As it is now before us, the bill is a positive step in the direction of more efficient solutions to the broad range of problems which confront SIPC. In my judgment, this bill goes a substantial way toward improving the protections afforded securities customers and enabling SIPC to perform its role more expeditiously and efficiently.

As passed by the House, the Securities Investor Protection Act would achieve a number of important changes in the original 1970 act.

First: SIPC insurance coverage for customer's cash and securities would be doubled from the current level of $50,000—$20,000 for cash—to $100,000—$40,000 for cash. Securities investors will thus be guaranteed the same insurance protection for their cash under SIPC as bank and savings depositors receive under FDIC coverage.

Second: The bill would modify the act to provide protection which better comports with the expectation of both cash and margin customers. This would be accomplished by moving away from a strict insurance concept and toward a scheme of returning customers' accounts intact as they existed when the broker-dealer became insolvent. The benefits to the customers of firms in liquidation will be immeasurable since they will no longer be deprived for lengthy periods of the use of, or access to, their cash or securities.

Third: Liquidation procedures would be streamlined and the cost of liquidations reduced by authorizing SIPC to make payments directly to customers without the necessity for a judicial proceeding. And SIPC would itself be the trustee for liquidation of small brokers and dealers where the claims do not exceed $750,000 and where there are fewer than 500 customers.

Chairman Owens, who is, of course, a necessary witness, I would like to say to you that with this bill you have fully discharged your

commitment to the committee, to SIPC's 5,500 members, and to millions of public investors. It is not often legislation enacted in haste works as smoothly or as successfully as SIPC has over the years. Much of the credit belongs to you for your continuing leadership and to the other Directors. While I hope SIPC's services are not in great demand in the years ahead, I believe the program is entrusted to extremely qualified able, and experience individuals who can discharge properly the additional duties the bill would confer upon SIPC.

So we will begin now. The bell signals that there is a vote on now, a 10-minute rollcall, so it might be wiser for us, Chairman Williams, for me to go over and do that and return and then we will hear the Chairman of the Securities and Exchange Commission.

[Short recess.]

Senator WILLIAMS. Chairman Williams, we are very pleased to have you and have your statement.

STATEMENT OF HAROLD M. WILLIAMS, CHAIRMAN, AND PHILIP A. LOOMIS, JR., COMMISSIONER, SECURITIES AND EXCHANGE COMMISSION, ACCOMPANIED BY ROBERT J. MILLSTONE, SENIOR SPECIAL COUNSEL, DIVISION OF MARKET REGULATION

Mr. WILLIAMS. Thank you, Mr. Chairman. It is a pleasure to appear before you today to submit the Commission's views on H.R. 8331, the Securities Investor Protection Act Amendments of 1977.

I am accompanied today by Commissioner Philip A. Loomis, Jr., and Robert J. Millstone, Senior Special Counsel of the Commission's Division of Market Regulation.

These two gentlemen have indepth knowledge of and historical continuity with the SPIC legislation.

I might note at the outset, Mr. Chairman, our recognition also of the effectiveness and the success of a piece of legislation that was drafted on a crash basis to address an urgent problem and to provide a sense of confidence and stability to the securities markets, which was badly needed at the time.

I would also like to express our appreciation for the outstanding leadership and dedication of Chairman Owens and the other Directors in implementing the legislation.

[The prepared statement read by Chairman Williams follows:]

STATEMENT OF HAROLD M. WILLIAMS, CHAIRMAN, SECURITIES AND EXCHANGE COMMISSION

Mr. Chairman and members of the Subcommittee, it is a pleasure to appear before you today to present the Commission's views on H.R. 8331, the proposed amendments to the Securities Investor Protection Act of 1970. I am accompanied today by Commissioner Philip A. Loomis, Jr., and Robert J. Millstone, Senior Special Counsel of the Commission's Division of Market Regulation.

As you know, the Commission has long advocated amendments to the SIPC Act. Early in SIPC's life, we recognized the need to make the Act more flexible in order to permit SIPC ot meet effectively the broad range of problems which confront it. In addition, with the passage of time, the need to provide public investors with greater protection against the financial failure of their stockbrokers became apparent. In 1973, SIPC Chairman Owens ap-

pointed a task force to explore these problems, and Mr. Millstone, who is with me today, devoted considerable time to its deliberations. The Commission urged enactment of the Task Force's recommendations, which are in large measure embodied in H.R. 8331, when this Subcommittee first requested comments on amendments to the Act of 1975.

Since that time, the Commission and its staff have continued to work with Congress in an effort to develop a comprehensive and effective bill. Last August, we presented lengthy testimony and written comments to the Subcommittee on Consumer Protection and Finance of the House Interstate and Foreign Commerce Committee during its hearings on H.R. 8331. I would like to offer to this Subcommittee a copy of the statement and comments we submitted to the House Subcommittee on that occasion.

We believe the House Subcommittee did a commendable job of examining and resolving several difficult issues raised by the proposed legislation, thus paving the way for House passage of the bill now before you. As a result, the few concerns we expressed regarding the original version of H.R. 8331 have been satisfactorily resolved, and we urge enactment of the proposed satisfactorily resolved, and we urge enactment of the proposed legislation. I would like to highlight some of the important changes which this bill would effect.

The bill raises each customer's total SIPC protection to $100,000, of which $40,000 would be available to satisfy the customer's claims for cash. The increased amounts over the current $50,000 for securities and $20,000 for cash are intended not only to provide greater protection to investors, but also to strengthen confidence in the U.S. securities markets. In addition, several sections of the bill, taken together, assure that investors who fall within the specified limits of protection will, in nearly all cases, receive back their accounts as they stood on the filing date. This means that customers who have claims for securities will receive those securities rather than a cash payment for them. The investors will not, therefore, be placed at the risk of the market, unable to make investment decisions until payment of their claims by the trustee. In addition, the more efficient procedures provided in the bill—including a procedure under which, in small cases, SIPC will satisfy customer claims directly, without the expense and delay of a court proceeding—will permit more expeditious resolution of customers' claims.

Proposed Section 3 of the bill empowers SIPC to adopt certain types of rules and specifies the rulemaking procedure. While the Commission is generally satisfied with the proposed procedure, I would like to note a potential problem. As you are aware, this procedure is modeled after Section 19(b) of the Securities Exchange Act, which was enacted by the Securities Acts Amendments of 1975. The Commission's experience in administering Section 19(b) has led us to conclude that the fixed time frames provided in that section are, in some cases, too rigid and may create unnecessary burdens for both the Commission and the affected self-regulatory organizations. We considered suggesting certain revisions of the rulemaking procedure in the SIPC Act to deal with those problems, but concluded that there is an advantage to maintaining comparability between the two acts.

Because of practical and jurisdictional problems, registered broker-dealers whose principal business is conducted outside United States territory would be excluded automatically from SIPC membership unless SIPC allows them to become members. Broker-dealers excluded from SIPC membership under this provision would have to disclose to their United States customers the fact that they are not SIPC members and other relevant information required by the Commission.

Broker-dealers engaged exclusively in the distribution of mutual funds, variable annuities, the business of insurance or the business of rendering investment advice to investment companies and insurance company separate accounts would continue to be exempted from SIPC membership, and revenues received by SIPC members from those sources would continue to be excluded from SIPC assessments. The House report, in discussing the decision to continue this exclusion, reflects a determination that the distribution of mutual funds and variable annuities does not create the risk created by general brokerage activities. While we suggested a different approach to the House Subcommittee, this outcome is satisfactory to the Commission.

In order to increase public awareness of SIPC and the protections it provides, SIPC is authorized to prescribe in its by-laws such minimal requirements

as it considers necessary and appropriate to compel members to provide public notice of their membership in SIPC.

Finally, revenues derived from transactions in money market instruments would be assessable for the first time, reflecting that SIPC has experienced some losses relating to those instruments. Because those losses have been relatively small, however, only a portion of the revenues from money market instruments, based on SIPC's loss experience, would be included in a member's gross revenues for purposes of computing its assessment.

We believe that the proposed legislation would streamline SIPC procedures, reduce administration costs—thus reducing the assessment burdens on SIPC members, and enhance customer protection. This would be a substantial accomplishment. Accordingly, the Commission strongly supports H.R. 8331 and urges the Senate to enact it promptly.

That completes my prepared statement. Commissioner Loomis, Mr. Millstone, and I will be happy to respond to any questions the Subcommittee may have.

Senator WILLIAMS. Thank you very very much. Do either of you other gentlemen have anything to say on direct?

Mr. LOOMIS. No, I don't believe so. I don't, Mr. Chairman.

Senator WILLIAMS. What is the Commission's view of the proposal to permit SIPC to require its members to display the SIPC symbol or otherwise give notice of their membership in SIPC?

Mr. WILLIAMS. Mr. Chairman, the Commission has no official position on this issue.

As we understand SIPC's position, since not all broker-dealers are members of SIPC, there would be an advantage in the interest of public customers to identify those that are. Apparently, there is also a sense on SIPC's part that public awareness of the availability of SIPC protection could play an important role in investment decisions and could lead to investor confidence.

As we understand the position of some brokers, they are concerned that the customers, seeing the logo, might think the broker is concerned about going broke, and has, therefore, provided for that contingency.

Some have analogized the proposed SIPC symbol to that used by the FDIC. The FDIC symbol certainly has been viewed over time as a symbol of some degree of Government insurance. But the nature of SIPC protection is considerably different; it is not an insurance against all loss, it is a form of insurance against only losses attributable to the insolvency of a broker-dealer. The analogy to the FDIC symbol is therefore, of limited value, unless the difference in the breadth of protection is clearly understood.

As we see it, the portion of the bill relating to the proposed symbol does not mandate any action. SIPC would simply be authorized to propose requirements by rulemaking, which would enable the public to comment on the rule. We would have the opportunity to review that rule, and if, at that time, we believed that certain exceptions were appropriate, we could provide for them.

Senator WILLIAMS. While you aren't entirely happy with the provision dealing with rulemaking, in terms of its time frame, you accept what is in this bill?

Mr. LOOMIS. I believe so, yes, that is our position. We have had problems with the time frame of the comparable provision in the Exchange Act; we don't have much experience with the SIPC Act.

But we don't think that Congress should bother to consider revising the rulemaking provision in the SIPC Act unless and until it looks at the whole subject in the context of the Exchange Act as well.

Senator WILLIAMS. What is the rulemaking test? This is drawn from the other act. What is the rulemaking test here to avoid abuse?

Mr. LOOMIS. Well, you mean the time frame?

Senator WILLIAMS. Not the time frame, the——

Mr. WILLIAMS. The procedures used?

Senator WILLIAMS. Yes.

Mr. LOOMIS. Well, the general standard isn't very clearly specified. It simply specifies that the Commission shall—I am looking for the exact language.

Senator WILLIAMS. Is that an "arbitrary and capricious test?"

Mr. LOOMIS. Conceptually it is the same public interest standard that we have in the Exchange Act.

Mr. WILLIAMS. Procedurally, the rule changes will be published for public comment, and they are subject to Commission review. In addition, the Commission is authorized to require SIPC at any time, "to adopt, amend, or repeal" any SIPC rule, so the opportunity for arbitrariness is pretty well precluded.

Mr. LOOMIS. The standard essentially is whether the rule in question is necessary or appropriate in the public interest to carry out the purposes of the act.

Senator WILLIAMS. I think that covers us very well. Thank you very much.

Now from SIPC, Chairman Hugh Owens, General Counsel and Secretary, Mr. Theodore H. Focht, and the Vice President-Finance, Mr. Lloyd W. McChesney.

STATEMENT OF HUGH F. OWENS, CHAIRMAN OF THE SECURITIES INVESTOR PROTECTION CORP., ACCOMPANIED BY THEODORE H. FOCHT, GENERAL COUNSEL AND SECRETARY, AND LLOYD W. McCHESNEY, VICE PRESIDENT, FINANCE

Senator WILLIAMS. I included all of my praise in the statement opening the hearings, Chairman Owens. You are very good in your chairmanship, in what you have done with SIPC.

Mr. OWENS. Thank you very much. Mr. Chairman, on behalf of not only myself, but my colleagues, we are very grateful for your kind remarks.

[The statement read by Mr. Owens follows:]

STATEMENT
BY HUGH F. OWENS, CHAIRMAN,
SECURITIES INVESTOR PROTECTION CORPORATION
BEFORE THE
SUBCOMMITTEE ON SECURITIES
COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
UNITED STATES SENATE
April 25, 1978

Mr. Chairman, and members of the Subcommittee, it is a pleasure for me to appear before you this morning and present the views of the Securities Investor Protection Corporation ("SIPC") on H.R. 8331, the Securities Investor Protection Act Amendments of 1977. This bill was passed by the House of Representatives on November 1 of last year. It would make important improvements in the program established by the Securities Investor Protection Act of 1970 ("SIPA"), and SIPC supports the legislation in its present form.

Before I review some of the many important improvements which H.R. 8331 would make in SIPA, perhaps it would be useful if I summarized briefly the activities of SIPC since its creation in December 1970. As many of you will recall, SIPA had its origins in the difficult years of 1968-1970 when the paper crunch brought on by an unexpectedly high trading volume in securities was followed by the most severe decline in stock prices since the Great Depression. Hundreds of broker/dealers were merged, acquired or simply went out of business. Some were unable to meet their

obligations to their customers and went bankrupt. Public confidence in our securities markets was in jeopardy.

In order to protect customers of failed broker/dealers against financial loss and, thereby, restore investor confidence in the securities markets, Congress passed SIPA. That statute, which was signed into law on December 30, 1970, created SIPC and established a program whereby monies from the SIPC Fund would be available for the purpose of protecting customers of broker/dealer firms which encountered financial difficulty. As the statute now stands, SIPC may advance a maximum of $50,000 to protect the claim of any one customer of a failed broker/dealer, but no more than $20,000 of that amount may be advanced to pay claims for cash as opposed to claims for securities. These payments supplement distributions of available securities and cash from the debtor's estate.

Since the enactment of the SIPC legislation, 129 of the over 8,700 broker/dealers which have been SIPC members over the past 7 years have been liquidated under SIPA. As of March 31, 1978, SIPC had made net advances to trustees totaling $54,518,825. In addition, significant amounts of securities and cash in the debtor's possession have been distributed to customers by the trustees. We estimate that to date securities and cash having a value of over $279 million have been distributed to approximately 105,000 customers in the course of liquidation proceedings. We believe

these figures demonstrate vividly the effect which the SIPA program has had on investors throughout this country and point up the wisdom of Congress in establishing SIPC and the SIPA program in 1970.

As of March 31, 1978, SIPC had assessment revenues from its members which totaled over $198 million. In addition, SIPC had earned approximately $31 million in interest income on its investments, giving SIPC total revenues of $229 million. SIPC's expenses from inception to this date totaled approximately $64.5 million. As noted above $54.5 million of that total represents advances made to trustees in SIPA liquidations and the balance represents overhead expenses for SIPC's operations to date. It may be noted that SIPC's expenses for its internal operations have been slightly less than one-third of the interest income SIPC has earned on its investments. Currently, the SIPC Fund totals approximately $161.5 million.

I mentioned earlier that 129 members have been or are being liquidated under the provisions of SIPA. It is interesting to note the spread of those liquidations over the years of SIPC's operations.

1971	-	24
1972	-	40
1973	-	30
1974	-	15
1975	-	8
1976	-	4
1977	-	7
1978 (3 months)		1

We are pleased with the declining number of liquidations. While we recognize that there is probably no single cause for the decline, I am confident that one of the principal factors is the positive action taken by the regulatory and self-regulatory authorities over the past years. These actions are manifested not only in strengthened rules and regulations regarding entry qualifications and operating standards, but also in improved surveillance and inspection programs. These activities have had, and will continue to have, SIPC's full support and cooperation.

In some respects the bill before you today had its genesis in this Committee on November 1, 1973, when I appeared before you for my confirmation hearings at the time of my first nomination as Chairman of SIPC. At that time members of the Committee expressed considerable interest in a review of the SIPA program and in any recommendations SIPC may have for amendments to SIPA. Partly as a result of that interest, one of my first acts as Chairman of SIPC was to appoint a Special Task Force to review the statute and its operations and to make recommendations to our Board of Directors for amendments to achieve better, faster and more efficient methods of investor protection. That Task Force was headed by SIPC's General Counsel and was composed of representatives of the groups which have an interest in the SIPA program. The Task Force met almost weekly during the first half of 1974 and issued its report in July of that year. The Task Force, although composed of persons representing organizations

with diverse views, was able to arrive at a consensus on almost all subjects. The Task Force's recommendations are designed to obtain the goal which we all want, namely, increased investor confidence through a viable and efficient SIPA program.

After careful study of the Task Force's report, SIPC's Board of Directors approved virtually all of its recommendations. These were subsequently incorporated into legislative proposals which were transmitted to the 93rd Congress in December 1974, at which time they were introduced as S. 4255 and H.R. 17684. In the 94th Congress the proposals were contained in S. 1231 and H.R. 8064. In the 95th Congress H.R. 8331 was introduced in the House of Representatives in July 1977, and hearings were held by the appropriate subcommittee of the Committee on Interstate and Foreign Commerce on August 1, 2 and 3, 1977. The bill was approved by the House of Representatives on November 1, 1977. Frankly, the provisions of H.R. 8331 contain some significant changes from the proposals first transmitted to the Congress in December 1974 by SIPC. After review and reflection, however, we urge the approval of H.R. 8331 as it presently stands. We believe it is a reasonable compromise and blend of the various views which have been presented; unquestionably, it will produce efficiencies in SIPC's operations and especially in liquidation proceedings which take place under SIPA. In addition, the legislation is designed to make the SIPA program more responsive to the reasonable expectation of investors.

On the subject of efficiencies in SIPA liquidations, the legislation will provide more flexible procedures for the liquidation of a broker/dealer. At present, SIPA provides only one set of procedures for conducting a liquidation under the statute. To date, we have applied those procedures to the liquidation of Lang-Lasser & Co. which had five customers claiming cash or securities as well as to Weis Securities, Inc., which had 34,000 such customer claims. We believe the framers of SIPA, when they established the procedures for liquidating broker/dealers, had in mind the liquidation of large firms such as Weis Securities. But in the bulk of SIPA liquidations those procedures have had to be used to liquidate firms which are considerably smaller. For example, in almost one-quarter of our liquidations to date, there have been less than 50 customer claimants. We believe the procedures should be modified somewhat for firms of varying size.

Accordingly, under Section 10 of SIPA as amended by the bill the satisfaction of customers' claims of firms with a small number of such claims could be handled by SIPC directly without the time and expense of a judicially supervised liquidation through what is termed a direct payment procedure. Under that section, SIPC is given discretion to make payments directly to customers if certain conditions are met. The section protects the customers' interest by providing that the distributions of cash and securities to customers should be made as in a liquidation proceeding. It is intended that the direct payment procedure will be utilized only in cases where the failed broker/dealer has terminated or is about to terminate its business.

The objective is to assure that this procedure will not be used to permit a broker to continue in business once SIPC has satisfied the claims of the firm's customers. We expect that the direct payment procedure will speed distributions to customers in small cases with a minimum of administration expense and without sacrificing the customers' rights to have court hearings as to disputes concerning their claims.

In those cases where there would be a judicially supervised liquidation, the bill would give SIPC the right to designate itself or one of its employees as trustee in cases where the failed firm's liabilities to unsecured general creditors and subordinated lenders appear to be less than $750,000 and there appear to be fewer than 500 customers. Local counsel would still be retained. We believe that this change will also help to expedite the liquidation process and result in substantial savings of administration expenses. Under the present statute, it is questionable whether SIPC may insist that a SIPC employee serve as trustee. In a number of cases we have sought such appointments, but in only five cases have the courts been willing to make the appointments. In those five cases we have found a significant reduction in total administration expenses, and we believe the statute should be amended to authorize clearly such procedure.

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An analysis of the liquidation cases closed to date indicates that a substantial percentage of the cases might have been conducted under the direct payment procedure or with SIPC or one of its employees serving as trustee. While it is not possible to state with precision the dollar impact of that, I am convinced that it would be substantial.

Of even more importance than these changes, however, are the improvements in the protection which would be afforded to customer claimants. One such improvement which has perhaps received the most interest is the proposed increase in the amount of money which SIPC can advance to a trustee for the protection of any one customer's account. As you know, under the current statute the limits are $50,000 with a maximum of $20,000 to satisfy a claim for cash as opposed to a claim for securities. Under the provisions of H.R. 8331, these limits would be increased to $100,000 and $40,000, respectively. This corresponds to the changes in 1974 in the FDIC, FSLIC and FCUIC legislation which doubled the coverage for depositors. We believe this is a necessary and appropriate improvement in the SIPA program. Of the 105,000 claims satisfied in all liquidation proceedings to date, there have been only 172 customers in 40 liquidations with claims for cash and/or securities over the SIPA limits. That is about one-sixth of one percent of all claims received. In terms of dollars, the amount of these claims which could not be satisfied came to approximately $3,400,000. Had the proposed higher limits of protection been in effect

on these claims, the total additional cost would have been approximately $2,200,000. Only 23 customers in 13 liquidations would not have had their entire claim satisfied.

Another important improvement would be in the manner in which a customer's claim is satisfied. Under the present statute customers with claims for securities have their claims satisfied by the delivery of securities only if the debtor has securities of that class and kind available in sufficient quantities to satisfy the claims. If not, the statute requires the trustee to pro rate the available securities and pay customers cash in lieu of any missing securities. Since in many instances securities have been lost, improperly hypothecated, misappropriated, never purchased, or even stolen, customers frequently receive cash for some or all of the securities they claim. This has caused considerable distress to many customers. Indeed, while we were preparing for these hearings we received a letter of comment on this subject from a doctor in Minnesota who was hard pressed to understand why his claim for securities was not satisfied by delivery of the securities rather than cash in lieu. We understand the expectations of customers who wish to have their claims satisfied in kind. Accordingly, the bill would provide that, to the extent the trustee has insufficient securities to satisfy claims, he should purchase in the open market the additional securities needed so long as he can do so in a fair and orderly market.

The bill would also empower a trustee to pay, subject to SIPC approval, bank loans collateralized by securities, including margin securities, thereby reclaiming those securities for distribution to customers. In appropriate cases, SIPC would be authorized to advance funds for this purpose.

Customers with margin accounts have expressed unhappiness with the netting which occurs in their accounts under the present provisions of SIPA. Many margin customers would prefer to pay the debit balance which they owe to the firm and receive all of the securities which are in their account. The bill specifically would provide for such procedure.

These proposals will enable the trustee, to a much greater extent than is now possible, to render accounts to customers in the same form as they stood when the member went out of business and to do so in a far more efficient manner. You may recall that these matters were very much on this Committee's mind at the time we first discussed changes in the SIPA program in November 1973. That concern at that time was highlighted by the failure of the only New York Stock Exchange member which has been liquidated under SIPA, namely, Weis Securities whose liquidation was commenced in May 1973.

There are many other important and significant improvements which the bill would make in SIPA. Because of the pressures on your time this afternoon, I will not review all the changes at this time. I wish, however,

to submit for the record a section-by-section explanation of H.R. 8331 which describes these changes. I would also like to submit for the record a second memorandum which details a few technical changes which we believe should be made in the bill. I would emphasize the word "technical." They are not substantive changes.

You undoubtedly are interested in the question of funding for the SIPA program. As I mentioned earlier, the SIPC Fund currently totals a little over $161 million. We believe the SIPC Fund is sufficient to support the program envisioned by this bill. We note that, while some of the proposals will give greater dollar protection to the public, there will be substantial savings in administration expenses in liquidation proceedings. While it is not possible to determine with precision the dollar amounts involved, we believe that the program envisioned by these amendments will not be significantly more costly overall than the present SIPA program. Then, also, we must keep in mind the dramatic decline in recent years of liquidations under SIPA. Of the 129 liquidations which have taken place under SIPA to date, 109 of them took place during the first four years of SIPC's operations and only 20 of them have taken place in the last 3 1/4 years. As detailed above, cash and securities having a value of over $279 million have been distributed to approximately 105,000 claimants in those proceedings. It is especially noteworthy that this has been accomplished without any expenditure of federal funds. Rather, the program has been financed completely from industry funds raised through assessments on SIPC members.

One final word about H.R. 8331. As I said earlier in my remarks, there have been accommodations and compromises which have taken place in the course of the consideration of these recommendations over the past four years. The most significant of these was on the question of the inclusion of mutual funds and similar items in the SIPA program. As the record will show, SIPC's views on this subject have not prevailed, and the existing exclusions for mutual funds and similar items are continued. We believe, however, that the time-consuming debate on these subjects must now come to an end and that H.R. 8331 as it stands should be enacted. The legislation before you is clearly in the public interest and will very substantially improve the protection which customers of all SIPC members will receive.

The SIPA program has proven its effectiveness in the seven plus years it has been in operation. It has contributed substantially to investor confidence in our nation's securities markets--a goal which this Committee and the Congress sought when it created SIPC in late 1970. The Board of Directors of SIPC is pleased to express its strong support for H.R. 8331. We hope that it will be enacted at the earliest practicable time by the Senate.

April, 1978

SECTION BY SECTION EXPLANATION OF H.R. 8331
AMENDMENTS TO SECURITIES INVESTOR PROTECTION ACT

The following is a section by section analysis of H.R. 8331, proposed amendments of the Securities Investor Protection Act of 1970 ("SIPA"). The italicized captions at the left hand margin refer to sections of the Bill. The explanation which follows each caption discusses the relevant sections of SIPA as amended by the Bill. Where appropriate, reference is made to the Report of the Special Task Force dated July 31, 1974 ("TFR").

Section 1

Self-explanatory.

Section 2

§3(a)(2) of the Act--Existing exemptions from SIPC membership are retained and, in order to solve existing jurisdictional problems, persons whose principal business, in the determination of SIPC (subject to review by the Securities and Exchange Commission), is conducted outside the United States and its territories and possessions are excluded from SIPC membership except upon such terms as SIPC shall require by rule. Accordingly, subsection 11(b) of the present SIPA is deleted (see section 14(c) of H.R. 8331).

Existing §3(f) is deleted. Experience under the present SIPA has shown that a provision allowing voluntary SIPC membership, other than for foreign broker/dealers covered by the proposed amendment to subsection 3(a)(2), is unnecessary.

Section 3

This section makes certain minor technical and clarifying changes, in addition to the substantive changes discussed below.

§3(b)(3) of the Act--A specific reference to SIPC's power to indemnify its directors, officers, and employees for acts done within the scope of their employment is added to present subsection (b)(3) concerning SIPC Bylaws. In view of the many new situations in which SIPC officials and employees will be called upon to exercise discretion, and particularly in view of the possibility of a SIPC employee serving as trustee, it was thought desirable to grant protection against whatever increase in exposure to suit may result from these new responsibilities.

§3(b)(4) of the Act--This new subsection permits SIPC to adopt substantive rules including rules defining terms used in SIPA and rules relating to liquidation proceedings and direct payment procedures.

Section 4

§3(c)(2)(C)(ii) of the Act--This amendment makes a technical change to conform to changes in the 1934 Act.

§3(c)(5) of the Act--Reference to the determination of dollar volume of trading on exchanges is deleted. Its inclusion in the present SIPA is the result of an unintended carry-over from earlier SIPA bills which used the concept.

Section 5

§3(e) of the Act--Provisions regarding initial bylaws are deleted. In addition, procedures are established for the adoption, amendment and repeal

of bylaws and rules. Bylaws generally remain subject to the procedure described in the present Act, unless the Commission finds that a matter relating to a bylaw is of such significant public interest that it should be handled according to the procedures used for rules. With respect to rules, new procedures are adopted which are appropriate to legislative, rather than interpretative, rules, since it is intended that SIPC's rules will have the force and effect of law. Power to develop rules which will clearly control the myriad problems and disputes which arise in the course of liquidations will substantially aid in the administration of the statute.

Section 6

This section makes various technical and clarifying changes in addition to the substantive changes discussed below.

§4(a)(2)(C) of the Act--This amendment provides that confirmed lines of credit maintained by SIPC pursuant to subsection 4(a)(4) are not to be included in calculating the balance of the fund. (See TFR p. 48)

§4(i) of the Act--The requirement that, except as otherwise provided by SIPC bylaw, gross revenues from the securities business be computed on a consolidated basis is modified by excluding from the required consolidation the foreign subsidiaries of a SIPC member. This change is in line with the amendment to the customer definition (§16(3) of the Act) to exclude persons to the extent that their claims arise out of transactions with foreign subsidiaries of SIPC members.

§4(d)(1)(C) of the Act--This new provision imposes a minimum assessment of $25 per year through 1979, with the minimum assessment thereafter to be set by SIPC, but not to exceed $150 per year. The purpose is to insure that a member's assessment covers the resulting administrative cost incurred by SIPC. (See TFR p. 48)

§4(a)(4) of the Act--The amendment clarifies SIPC's authority to maintain confirmed lines of credit separate from the fund (see §4(a)(2)(C) above), thereby diminishing the possibility that SIPC will be forced to borrow from the United States Treasury. (See TFR p. 48)

§4(e)(3) of the Act--By this provision SIPC is empowered to levy a penalty for late payment of assessments in addition to the interest charges currently permitted by the Act. (See TFR p. 49)

Section 7

§5(a)(2) of the Act--This section would clarify the authority of self-regulatory organizations to assist in or take such action with respect to a member in financial difficulty as may be appropriate to protect customers of the member. Timely action by a self-regulatory organization under this sub-paragraph may obviate the need for a SIPC liquidation. (See TFR p. 55)

§5(a)(3) of the Act--As under the present Act, the subsection entitled "Action by SIPC" empowers SIPC, on the basis of certain factual determinations, to apply for a court decree which sets in motion the customer protection and liquidation procedures. Amendments to this subsection would codify existing rules whereby only persons who are or have been members within the past 180 days are potential subjects of SIPC action [see 17 C.F.R. §§240.15b5-1; 240.15b6-1] and would make it clear that SIPC has no obligation to act where no customer interests of the kind protected by SIPC are involved. (See TFR p. 44) For convenience of reference, the decree for which SIPC is empowered to apply under this paragraph is termed a "protective decree," and is defined in §16(14) of the Act (see §15 of the Bill).

§5(b)(1) of the Act--A new subsection, consolidating present subsections (A) and (B), is intended to eliminate whatever ambiguity may have existed concerning the action to be taken by a court when presented with a SIPC application. The substance of existing subsection (B) is unchanged except that an application to which the debtor gives its consent will be granted without delay.

§5(b)(2) of the Act--This subsection, relating to the jurisdiction of a court, does not make significant substantive changes from SIPA as now in effect.

This and subsequent sections, however, reflect the approach taken to the conceptual and drafting problems involved in defining the precise relationship between SIPA and the Bankruptcy Act. The aim of these revisions is to make a liquidation proceeding subject to the provisions in the Bankruptcy Act relating to ordinary bankruptcy, except for those provisions relating exclusively to stockbrokerage liquidations. Incorporation of chapter X (relating to reorganizations) is eliminated, since many of its provisions are inappropriate in the context of a liquidation. Those chapter X provisions considered particularly desirable in a liquidation proceeding have been selectively incorporated. Complicating the task of drafting language to carry out these intentions is the expectation that the Bankruptcy Act may be amended and renumbered in the near future. (See TFR p. 34)

Accordingly, the "Bankruptcy Act" is defined in subsection 16(1) to mean the statute and rules relating to ordinary bankruptcy. Chapters I-VII are mentioned only parenthetically with a view to the possibility that the comparable provisions of an amended Bankruptcy Act will be differently designated.

Added here, as well, are jurisdictional provisions which reflect case law developed under chapter X. Although the proposed amendment retains the language of the present Act (which was drawn from chapter X), it is thought prudent to include also the precedents developed under that section, lest a court be tempted to interpret the language differently now that it is divorced from chapter X of the Bankruptcy Act. Accordingly, it is provided in §5(b)(2)(A)(i) that the court may issue orders protecting property in the

actual or constructive possession of the debtor located outside the territorial limits of the court. See, e.g., Continental Illinois National Bank & Trust Co. v. Chicago Rock Island & Pacific Ry., 294 U.S. 648 (1935). This protection is not available in ordinary bankruptcy. §5(b)(2)(A)(i) also incorporates the rule that a chapter X court has jurisdiction over property in the possession of a secured creditor who does not challenge the debtor's title but maintains a right to retain the property as security or subject to a lien. See, e.g., 6 Collier on Bankruptcy ¶ 3.05 (14th ed. 1976); Continental Illinois National Bank & Trust Co., supra; In re Prudence Bonds, 77 F.2d 328 (2d Cir. 1935).

§5(b)(2)(B) of the Act--This subsection incorporates the provisions of §§113, 116(4) and 148 of chapter X relating to stays.

§5(b)(3) of the Act--Three objectives are accomplished by amendments to this subsection. First, because of the numerous times courts have questioned the authority of SIPC to designate the trustee and his counsel, the existing provision that such designations are within the discretion of SIPC is sharpened. Second, it is made clear that the trustee and his counsel may be with the same firm. Finally, it is provided that SIPC has discretion to designate itself or one of its employees as trustee in certain cases, thus achieving, in the appropriate case, a substantial saving in expenses of administration. (See TFR p. 29)

§5(b)(4) of the Act--This provision clarifies the existing practice of referring any or all aspects of a liquidation proceeding to a referee in bankruptcy. See, e.g., Exchange National Bank v. Wyatt, 517 F.2d 453 (2d Cir. 1975). In many cases such a reference has speeded liquidation proceedings.

§5(b)(5) of the Act--Compensation of trustees and their attorneys is to be based on services rendered and costs incurred, the basis used in SIPC liquidations to date, rather than on the amount of assets marshalled. While both measures of compensation have support in the Bankruptcy Act, the primary purpose of the SIPC liquidation is to return property to customers of the debtor, regardless of whether that property comes from the debtor, from SIPC advances or from other sources. This subsection expressly provides for interim compensation. The subsection also requires SIPC to file a recommendation with respect to compensation, which recommendation is binding in "no-asset" cases unless the amount of compensation is disputed by the applicant. _Cf_. _SIPC v. Charisma Securities Corp._, 506 F.2d 1191 (2d Cir. 1974). In other cases, the recommendations of SIPC are to be given great weight.

§5(b)(6) of the Act--Incorporated here are the requirements of disinterestedness which now appear in SIPA only by reference to chapter X of the Bankruptcy Act. Since chapter X is not generally incorporated, it is now necessary to make express the provisions of §§157, 158 and 161 of chapter X. SIPC, however, is deemed disinterested in all cases, even though by subrogation or otherwise it may have a claim on the debtor's estate and even though the debtor may owe assessments as a member of SIPC. An employee of SIPC is considered disinterested unless his interest arises from a source other than his association with SIPC. The notice provisions for a hearing on disinterestedness conform with other notice provisions in these amendments.

§5(d) of the Act--This section is designed to make clear that SIPC, as the agency charged with the administration of SIPA, as advisor to the court, as

the party initiating a liquidation proceeding, and as the party which, to a large extent, funds a liquidation proceeding, is entitled to participate fully in all matters arising in a liquidation proceeding. In at least one case a party asserting a right to reclaim property in the possession of the trustee objected to SIPC's participation. This section confirms SIPC's right to participate, whether a particular matter is deemed part of a proceeding in bankruptcy or a controversy arising in a proceeding in bankruptcy. The language is drawn from section 208 of chapter X. See, SEC v. Krentzman, 397 F.2d 55 (5th Cir. 1968).

Section 8

§6(a)(1)(A) and (B) of the Act--Language changes here are consistent with the substantive changes to the concepts of "specifically identifiable property" (now termed "customer name securities" in subsection 16(4) below) and "single and separate fund" (now termed "customer property" in subsection 16(5) below).

§6(a)(2) of the Act--Present subsection 6(a)(2) is deleted pursuant to the decision of the Task Force that open contractual commitments of the debtor should not ordinarily be completed. (See TFR p. 31 and subsection 8(e) of the Act discussed below) An added purpose of a liquidation proceeding is to sell or transfer productive units of the debtor. (See TFR p. 26)

§6(b) of the Act--The paragraph entitled "Application of the Bankruptcy Act" in SIPA as now in effect is changed with a view toward making a liquidation proceeding, except as to those aspects (principally relating to the satisfaction of customer claims) which are unique to stockbrokerage liquidations, subject to the Bankruptcy Act provisions relating to liquidations under ordinary bank-

ruptcy. (See subsection 5(b)(2) of the Act discussed above and subsequent discussion). Accordingly, a liquidation proceeding is to be conducted in accordance with, and as though it were being conducted under, specified provisions of the Bankruptcy Act. As is made clear in §16(1) of the Act, a simple reference to the Bankruptcy Act has the effect of incorporating the currently effective provisions relating to ordinary bankruptcy. Reference to chapter X is deleted as inappropriate, since the aim of a SIPA proceeding is the liquidation, not reorganization, of a member.

Existing §6(c)(2)(A)(1), defining the term "property", is deleted. Since treatment of cash and securities is not always the same, it is considered preferable to indicate in the substantive provisions themselves whether they apply to cash or securities or both. "Property," therefore, is no longer a useful term. The reference to "property of a similar character" has caused confusion, and has been deleted in favor of an inclusive definition of the term "security" in subsection 16(15) of the Act.

§6(c) of the Act--This amendment reflects the view that a customer who has entered into transactions in good faith after the filing date should not be barred from certain protections. (See TFR pp. 10 and 42)

§6(e) of the Act--It is made clear in this subsection that certain advances by SIPC will be deemed to be costs and expenses of administration, and will be recouped as such. Other claims against the general estate have the same priority they would have under the Bankruptcy Act.

Section 9

§7(a) of the Act--Pursuant to the decision to delete the general incorporation of chapter X of the Bankruptcy Act (see §5(b)(2) of the Act above and accompanying discussion), the powers with which the trustee is vested by this section are described simply as those of a trustee under the Bankruptcy Act, together with those powers specifically granted in subsections (1), (2) and (3), which may be exercised only with SIPC approval.

§7(a)(1) of the Act--The powers granted here are the same as those granted by §6(b)(1)(A) of the existing Act.

§7(a)(2) of the Act--The trustee is specifically authorized to use SIPC employees in connection with a liquidation proceeding, thus making their experience in handling such proceedings available directly to the trustee. It is anticipated that this will increase both the speed and efficiency of liquidation proceedings.

§7(a)(3) of the Act--The trustee is authorized to maintain customer accounts to facilitate their transfer under subsection 8(f) of the Act. As in the amendment to subsection 6(a) above, reference to completion of open contractual commitments is deleted.

§7(b) of the Act--As elsewhere, incorporation of a particular section of the Bankruptcy Act has been deleted in favor of a general reference which will not be disturbed by amendment and renumbering. In addition to the duties incumbent on a bankruptcy trustee, the SIPA trustee is charged with the following duties: to deliver securities to customers to the maximum extent possible, and, under appropriate circumstances, to guarantee the debtor's indebtedness

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to a bank to obtain the securities pledged as collateral therefor. (See TFR pp. 9 and 10)

§7(c) of the Act--This subsection, expanded from current section 6(i), is intended to incorporate the reporting requirements of Bankruptcy Rule 218 and adds certain requirements peculiar to a SIPA liquidation.

§7(d) of the Act--This new subsection is based on Bankruptcy Act §167 from chapter X, which is somewhat broader in scope than the comparable provision relating to ordinary bankruptcy. It may be particularly useful in investigating the causes of a stockbrokerage liquidation with a view to marshalling assets for the estate.

§8(a)(1) of the Act--Here again, specific incorporation of the Bankruptcy Act is deleted (see discussion in connection with §5(b)(2) above). To eliminate any ambiguity in the use of the term "customer", the trustee's duty to give notice is made applicable only to those customers who appear to have had an open account with the debtor within the 12 months preceding the filing date. Notice to creditors is the same as under the Bankruptcy Act, except that it is given by the trustee rather than by the court.

§§8(a)(2) and (3) of the Act--The limitations of time in SIPA as now in effect are altered to fit the contours of the new distribution scheme. It is provided that claims for customer property must be filed promptly, reflecting the trustee's need for certainty in regard to allocation of customer property at an early date. SIPC protection, however, may be extended to claims filed within six months. Important in this connection is the provision that the trustee may

satisfy claims filed between 60 days and 6 months after the date of publication of notice in the most economical way. This is necessary to protect SIPC against market risk arising from customers' withholding their claims for the purpose of speculation. It was considered appropriate in the subsection concerning notice and claims to include the provisions of present §§6(g) and (h) relating to the appropriate form of response by customers to the notice. Accordingly, the provisions allowing informal claims by customers except customers associated with the debtor are included here. It is made clear, however, that this does not dispense with the need to file a written claim. (See TFR p. 43)

The claims of creditors other than customers are governed by a provision that tracks the current Bankruptcy Act, except that the time period runs from the date of publication rather than from the first date set for the first meeting of creditors. This is to anticipate the possibility that first meetings may be eliminated when the Bankruptcy Act is revised. To eliminate ambiguity, it is stated that claims must actually be received by the trustee within the six-month period. As under the present statute, neither customer nor other creditor claims may be allowed if received after that period.

§8(a)(4) of the Act--The substance of existing subsection 6(j) is preserved in this subsection.

§8(b) of the Act--The subsection entitled "Payments to Customers" is retained without major change even though the manner in which the trustee effects "payment" will, in most instances, be substantially different. The trustee's power to satisfy claims in either cash or securities must be preserved, however, to enable him to deal properly with the situation in which there is not a "fair and orderly market" available within the meaning of §8(d) and the situation in which a customer makes a late claim that is nevertheless entitled to protection under §8(a). In addition, it is made clear that securities are valued as of the filing date for the purpose of determining what securities a customer is entitled to receive.

§8(c)(1) of the Act--This, the operative provision with respect to customer property, provides that each customer will be allocated a ratable share of customer property based upon his net equity. This allocation is fundamental to the process of determining the extent to which SIPC protection will be available to a customer, because SIPC advances are applied to the difference between a customer's ratable share of customer property and his net equity claim. Customer property remaining after the satisfaction of SIPC claims based on certain advances and all customer claims against it becomes part of the general estate. Any excess of a customer's net equity over his allocated share of customer property plus the protection available from SIPC is a claim against the general estate.

§8(c)(2) of the Act--The trustee is required by this subsection to return customer name securities to the customers in whose names they are registered or to deliver them on such customer's behalf.

§8(c)(3) of the Act--The substance of existing subsection 6(c)(2)(D) is preserved in this subsection which describes those transactions in customer property deemed to be voidable under SIPA. In addition to transactions void or voidable under the Bankruptcy Act, this subsection reaches transactions which have the effect of granting preferential treatment to individual customers.

§8(d) of the Act--This subsection, carrying out one of the central recommendations of the Task Force, authorizes the trustee to purchase securities for the purpose of restoring customers, as far as possible, to their positions as of the filing date (see TFR p. 9). To the extent he can do so in a fair and orderly market, the trustee would be expected to purchase securities to cover the deficiency remaining in a customer's account after allocating to such customer his share of customer property as provided in subsection 8(c)(1) of the Act. This would carry out a key objective of the Task Force which is the satisfaction of a customer's claim for securities by the delivery of securities wherever that is possible. The only time it is envisioned that a trustee would not deliver securities to satisfy a claim for securities would be in those situations where the market for the securities is so thin or so closely controlled by insiders that it would seem inappropriate and unwise for the trustee to be required to purchase securities for the satisfaction of claims. The trustee may use SIPC funds to purchase securities to replace that part of a customer's deficiency in securities whose value on the filing date did not exceed the limits of SIPC protection provided in subsection 9(a) of the Act.

§8(e) of the Act--The decision of the Task Force, the present policy of SIPC as expressed in the Commission's rule S6d-1, and the prevailing practice of trustees with respect to contracts of the debtor open on the filing date, are all reflected in this paragraph. In most instances, such contracts will be closed out. That is, the other contracting broker or dealer will complete the contract in the best available market, and account to the trustee for his profits or file a claim for his losses. If the closing-out broker or dealer was acting for a customer (as defined in subsection 8(e)(4) of the Act) with respect to contracts, he will be entitled to SIPC protection up to $40,000 for losses sustained for that customer. Where the closing-out broker or dealer was not acting for a customer, any loss he suffers will be a claim against the general estate, not payable from SIPC advances. (See TFR p. 31)

§8(e)(3) of the Act--Except as otherwise provided by SIPC rule, the provisions of §8(e) will not apply to a registered clearing agency which has its own rules on close outs for its participants. Losses by registered clearing agencies are claims against the general estate only, and not payable from SIPC advances. (See TRF p. 31)

§8(f) of the Act--This important new subsection gives the trustee the right to transfer in whole or in part the account of a customer. In view of the benefits to customers and the saving to SIPC that may result in an appropriate case, SIPC funds may be used to facilitate such transfer of accounts. (See TFR p. 11)

§9(a) of the Act--The provisions of SIPA as now in effect setting limits to SIPC advances are affected in three important respects, relating both to the dollar limits of advances and the manner in which they are applied to claims. First, the dollar figure for securities and cash claims is raised to $100,000, and the dollar figure for purely cash claims is raised to $40,000. Second, it is made clear that the limits are applied, not to the net value of a customer's account, but to the shortage remaining after the allocation of customer property, thus making the benefit of SIPC advances cumulative with whatever bankruptcy-type remedy the customer may have had. Finally, it is provided that the dollar limits do not apply, strictly speaking, to the SIPC advance itself, but, rather, to the filing date value of the securities in respect of which the advance is made.

§9(a)(4) of the Act--It is made clear in this subsection that persons with power of control over the debtor will not be protected by SIPC advances under any circumstances. (See TFR p. 42)

§9(a)(5) of the Act--Consistent with current practice the provision making brokers, dealers or banks ineligible to receive SIPC advances unless acting for a customer have been clarified by stating that a broker, dealer or bank is not considered to be acting for a customer where the customer is itself a broker, dealer or bank, or a person associated with the debtor.

§9(b) of the Act--Advances for customer-related losses on closed out contracts and expenses of administration where the debtor's estate is not sufficient to pay them are made mandatory.

§9(c) of the Act--This new subsection is added to permit SIPC to make discretionary advances to aid in reclaiming pledged securities under §7(b)(2), in transferring accounts under §8(f) and in purchasing securities under §8(d).

§10 of the Act--Administrative expenses incurred in small liquidations to date have been disproportionately large, both in relation to the size of the estates liquidated and the number of customers satisfied. The Task Force recommended, therefore that SIPC should have the authority to make payments directly to customers without judicial proceedings in appropriate circumstances. (See TFR p. 27) This new section is designed to permit such payments. It is important to note, however, that the direct payment procedures set forth in this section would only be used where the member's registration as a broker/dealer has been terminated or where the member planned to terminate its business and consented to the use of the direct payment procedure.

§10(a) of the Act--Guidelines are provided for the determination by SIPC that direct payment is appropriate. For SIPC to initiate direct payments in preference to a liquidation proceeding, it must appear to SIPC that (i) all customer claims are within the §9(a) limits, (ii) the sum of customer claims is less than $250,000, and (iii) direct payments will result

in a saving to the SIPC fund. SIPC must bring its discretion and experience to bear on this determination, and the decision to proceed by direct payment is not a purely mechanical one based on the existence of the enumerated conditions.

§10(b) of the Act--SIPC is to give notice by publication and mailing to the customers of the debtor as they appear from the member's books and records. Claims must be received within six months in order to be paid.

§10(c) of the Act--Payments are to be made and securities are to be delivered by SIPC in a manner similar to that in which the trustee is obligated to make payments and deliver securities in a liquidation proceeding.

§10(d) of the Act--Direct payment proceedings by SIPC are not to prejudice any right to pursue any other remedy a person may have had against the member.

§10(e) of the Act--The district court where the head office of the member is located is to have original jurisdiction of controversies relating to a person's right to direct payment. This preserves the right of a claimant to have his disputed claim adjudicated.

§10(f) of the Act--This subsection provides a safety valve in case changed circumstances make direct payments inappropriate or SIPC discovers that the situation is not what it appeared to be at the time of the determination under subsection (a). The decision to discontinue a direct payment procedure is entirely in SIPC's discretion, and the fact that, on the basis of hindsight, SIPC either would not or should not have commenced the direct payment

procedure does not mean that SIPC cannot, in the exercise of this discretion, continue the procedure. Prior payments or denials of a claim are nonetheless binding in subsequent proceedings.

Section 10

§11(a) of the Act--This section of the Act is section 7 of the existing Act. The Commission's rule-making power refers to subsection 3(e)(4) and to amend section 13(f). Conforming changes only are made in this subsection. SIPC is also given the authority to designate as collection agent a registered clearing agency which is not the examining authority for the member if it is the only self-regulatory organization of which the SIPC member is a member.

Section 11

§12 of the Act--Certain changes are made to conform to changes in section 13(a) of the Act.

Section 12

§13(a) of the Act--Where it would be more efficient to do so, SIPC is given the flexibility to designate a self-regulatory organization other than the examining authority to collect assessments from a SIPC member who is a member of more than one self-regulatory organization. (See TFR p. 49)

§13(b) of the Act--The immunity granted by this section is extended to cover self-regulatory organizations which act to assist their members in accordance with new section 5(a)(2). If self-regulatory organizations are to be encouraged to take prompt action to assist members in financial difficulty, they should not be held liable for good faith acts or omissions in connection with such action. (See TFR p. 56)

§13(c) of the Act--The existing provision as it was amended by the Securities Acts Amendments of 1975 with respect to the designation of the examining authority for brokers and dealers who are members of more than one self-regulatory organization is continued. In addition, if the self-regulatory organization of which a member of SIPC is a member or participant is a registered clearing agency, the Commission is given authority to designate itself as responsible for the examination of such member. (See TFR p. 49)

§13(f) of the Act--This section is amended to delete from section 9(f) of the existing Act certain powers of the Commission which are now granted to the Commission under the Securities Exchange Act of 1934.

Section 13

§14(a) of the Act--To conform to the amendment in subsection 4(e)(3), this subsection will refer to penalties as well as to other payments and interest.

§14(c) of the Act--Any attempt to defraud SIPC or a SIPC trustee by any means, and any act which, if taken in relation to a proceeding under the Bankruptcy Act, would be criminal, is made a criminal offense. (See TFR p. 53) The language of this section is drawn from 18 U.S.C. §152.

Section 14

§15(d) of the Act--Officers and employees are to be included in that class of persons not liable for action taken or omitted in good faith. The probability of SIPC employees acting as trustees in liquidation proceedings is a major, but not the only, reason for this inclusion.

§15(e) of the Act--This is to clarify SIPC's power to regulate the form and content of any public notice given by a SIPC member of its membership in SIPC or relating to the protections afforded under SIPA.

§15(b) of the Act--Existing subsection 11(b) of the Act regarding foreign members is deleted to conform to changes made in subsection 3(a)(2).

Section 15

§16 of the Act--This section collects various definitions which were scattered throughout the existing Act.

§16(1) of the Act--See discussion under §5(b)(2) of the Act.

§16(2) of the Act--Self explanatory.

§16(3) of the Act--The definition of "customer" should include only a person who enjoys the type of fiduciary relationship with the debtor that characterizes customers in general. Recent decisional law is codified in the definition to provide that only securities received "in the ordinary course of [the debtor's] business as a broker or dealer" may form the basis of a customer claim. See, e.g., SIPC v. Executive Securities Corp., 556 F. 2d 98 (2d Cir. 1977); SEC v. F. O. Baroff Co., 497 F. 2d 280 (2d Cir. 1974). Also, the Task Force agreed that customer status should not be extended to lenders of securities to the debtor where such lenders have received either collateral or consideration for their loans. Lenders of securities in such circumstances can reasonably be expected to bear the risk of the failure of the debtor's business. (See TFR p. 38; SIPC v. Executive Securities Corp., supra) Accordingly, some language from the current definition was dropped since it has been used by

some lenders in an attempt to gain for themselves the preferred position of customers. The deletion of the language is not intended to change the rights of cash or margin customers who lend securities from their trading accounts to their broker (without taking back collateral or receiving additional consideration). It is further provided that contributors to capital cannot become customers by avoiding the contracts pursuant to which they have contributed capital, e.g., on the grounds of fraud. Whatever their rights may be, it is not appropriate to treat such persons as customers. This is in line with recent decisional law. See In re Weis Securities, Inc., 425 F. Supp. 212 (S.D.N.Y. 1977).

Existing section 6(c)(2)(A)(iii), defining "cash customer", is deleted. That concept, closely related to the concept of "specifically identifiable property," is no longer useful. (See §§6(a)(1)(A) and (B) above) Further, the Task Force indicated that the distinction made by SIPA as now in effect between margin and cash customers is not in keeping with the goal of returning securities wherever practicable, or with the justifiable expectation of margin customers and others that they will be entitled to their accounts upon payment of debit balances. (See TFR pp. 10 and 11)

§16(4) of the Act--"Customer name securities" takes the place of "specifically identifiable property" as the category of securities which will be returned to individual customers outside the normal procedure for allocating and distributing customer property. Securities registered in the names of customers or in the process of being so registered on the filing date will be treated, in short, as though they are not part of the debtor's

estate, but merely held by the debtor as bailee. This, of course, is not intended to limit the exclusive jurisdiction of the court handling a liquidation proceeding to deal with customer name securities and any disputes concerning them. Excluded from this definition are securities in negotiable form, for example, securities registered in customer name but for which the customer has signed stock powers.

§16(5) of the Act--This section defines "customer property," the concept which takes the place of the "single and separate fund" of SIPA as now in effect. Customer property, briefly explained, consists of all cash and securities (other than SIPC advances and customer name securities) available to the trustee for the satisfaction of customer claims. It includes all cash and securities held from or for the accounts of customers, including the proceeds of any such property transferred or unlawfully converted. Also included is property generated from the use of debit items in customers' accounts and property of the debtor which, upon compliance with applicable laws, rules and regulations would have been set aside or held for the benefit of customers.

§16(6) of the Act--The definition of "debtor" is changed to make it conform to amended subsection 5(a)(3).

§16(7) of the Act--The definition of "examining authority" is changed to make it conform to amended section 13.

§16(8) of the Act--The definition of "filing date" is changed to make it conform to amended subsection 5(a)(3) and new section 10 of the Act.

§16(9) of the Act--A definition of the term 'foreign subsidiary' is added in light of the changes made in subsection 4(i) and the definition of 'customer'.

§16(10) of the Act--In light of the protections available under SIPA, the definition is expanded to include commissions earned from transactions in money market instruments, though SIPC by bylaw must determine an appropriate percentage of such commissions, based on SIPC's loss experience, as to which assessments will be charged. The change in existing subsection (K) (new subsection (L)) is designed to be a "catch all" category allowing SIPC by bylaw to pick up any revenues from the securities business not covered in the earlier subsections.

§16(11) of the Act--Self explanatory.

§16(12) of the Act--Changes to the definition of "net equity" reflect the views that margin and cash customers should be treated on an equal basis and that customers who have entered into transactions in good faith after the filing date should not be barred from certain protections. (See TFR pp. 10 and 42) Amendments to this subsection are also made necessary by the modification of the concept of "specifically identifiable property" and by the new provisions covering close outs of open contractual commitments.

§§16(13) and (14) of the Act--Self explanatory.

§16(15) of the Act--The new definition of "security" is essentially patterned after the definition in the Securities Exchange Act of 1934. However, in recognition of the fact that the definition in the 1934 Act is for the purpose of enforcement and regulation and that the purposes of SIPA are different, certain alterations in the definition are made. Certificates of deposit and short term instruments are included in the definition of securities for SIPC purposes; investment contracts, profit sharing plans, and interests in oil and gas leases are excluded unless registered with the Commission under the provisions of the Securities Act of 1933 or unless SIPC by rule determines that their inclusion in the definition of "security" is within the purposes or policies of SIPA. Commodity contracts and options relating thereto are also excluded.

Section 16

This section of the Bill amends section 3(a) of the Securities Exchange Act of 1934 by adding thereto a definition of the term "financial responsibility rules". That definition will then be applicable to SIPA by reason of section 2 of the Act, which makes applicable to SIPA those provisions of the 1934 Act which are not in conflict with SIPA.

Section 17

SIPA's table of contents is amended to conform to the changes made by the Bill.

SECURITIES INVESTOR PROTECTION CORPORATION

MEMORANDUM

April 25, 1978

Re: Technical Corrections to H.R. 8331, An Act in the Senate of the United States, November 3 (legislative day, November 1), 1977

We have noted the following errors in the above-referenced Act.

Page	Line	
3	5	Insert the word "company" as the first word of the line.
46	25	The parenthetical phrase which begins on line 23 should be closed on line 25 after the word "determination."
51	6	"16(3)" should be corrected to "16(5)."
52	3	The words "as redesignated by this Act" should be inserted after "(15 U.S.C. 78iii(a))."
54	19	The words "as redesignated by this Act" should be inserted after "(15 U.S.C. 78jjj(c))."
66	2	A comma should be inserted between the words "subscription" and "transferable."

28-082 O - 78 - 4

Senator WILLIAMS. Thank you very much, Chairman Owens. You will recall in the late 1960's when the trading volume exploded and SIPC was the result, and so was the Securities Act Amendments of 1975, which tightened up the regulation of broker-dealers, and increased SEC supervision of the operation and financial condition of broker-dealers.

Now how do you assess the condition of the securities industry today in terms of its ability to handle the record volume that we had recently?

Mr. OWENS. I would prefer to answer that question, if it is all right with you, Mr. Chairman, in the context of my experience at SIPC.

Senator WILLIAMS. Of course your experience is broader than SIPC. So when you say within your experience, you are going to say from your background with the Commission as well as with SIPC?

Mr. OWENS. I was limiting it right now in my first observation to SIPC.

Senator WILLIAMS. Don't feel obliged to.

Mr. OWENS. First of all, let me restrict it to the terms of our present operations, then my experience.

Senator WILLIAMS. Yes, in the first instance.

Mr. OWENS. In SIPC, yes. Our decline in liquidations has been dramatic. We went from a peak in 1972, when we had 40 liquidations, the next year we had 30, in 1974 we had 15, in 1975 we had 8, and in 1976 we had 4. It rose slightly last year to seven, most of them small firms.

So I think that this shows, as I say, dramatically that there has been a great shakeout in the securities industry.

My own personal opinion is that many of those failures were attributable to firms that shouldn't have been in the securities business in the first place.

Then, too, I think that another factor which has contributed substantially to the health of the industry is the action by the SEC, based upon some of the experiences to which you have alluded, in passing a net capital rule, 15c3–1, and a rule pertaining to customers' free credit balances, 15c3–3.

I think too economic factors have been a substantial component. And I think that the oversight by the selfregulatory agencies, particularly the NASD on smaller firms, has been outstanding in the last several years. All of these have contributed, I think, to the health of the industry, and I feel it has manifested itself in the decline of liquidations.

With respect generally to the securities industry and its ability to handle the back office problems, I would have to rely upon my general experience in that area, which goes back to my SEC experience and the hectic days when the broker-dealer community couldn't handle the paperwork, and the substantial reorganizations which the industry has made in its back office operations through computerization, et cetera. As a result thereof, I think we have a healthy industry. And I think that that is epitomized in the fact that we are

getting no notices of troubled firms. We get reports every week from the New York Stock Exchange, and we are perceiving no firms indicated to be in substantial capital trouble. Nor are we getting what we call a 5(a) notice with regard to troubled firms from the NASD. So I hope that answers your question, Mr. Chairman.

Senator WILLIAMS. When there was that breakdown in the back offices in 1969 and 1970, what kind of share days were we having then? What kind of a market was it?

Mr. OWENS. I will have to scratch a rather hazy memory in that regard. But I think they were doing in the neighborhood of 18 to 23 million shares.

Of course now we are seeing the industry handle twice that many in 1 day on a volume basis. But bear in mind that the industry at that particular time, as you well know, was just not equipped to handle that kind of volume. And the back office problem contributed materially to the trouble in which the industry later found itself.

Senator WILLIAMS. In getting ready technologically to handle the larger volume effectively and efficiently, that weakened firms, didn't it? Just the cost of technologically gearing up, followed by a weaker market, and that was one of the reasons for a weakening of many firms?

Mr. OWENS. I think that is correct, Mr. Chairman.

Senator WILLIAMS. Of course we have been within what, five years, in a period of numerous acquisitions and mergers. Has that reflected in any degree on the decreasing numbers of liquidations that you have faced because firms have merged?

Mr. OWENS. I am sure that that has been a factor to some extent, although I don't have precise figures on it. I cannot say how many failures we would have had if it had not been for some mergers or self-liquidations along the way.

But I think that this has been a factor, although, as I say, I don't have any specific figures on it.

Senator WILLIAMS. Does the SEC notify you of capital withdrawals from firms? Do you get any information from the SEC on that?

Mr. OWENS. No, sir.

Senator WILLIAMS. But the SEC gets that information, or do they?

Mr. OWENS. Let me ask Mr. McChesney about that question. Do you have an answer to that?

Mr. MCCHESNEY. Yes.

Senator WILLIAMS. I have heard that we are in a period of substantial capital withdrawal from the firms.

Mr. MCCHESNEY. As long as the firm stays actively in capital compliance, I am not aware, although perhaps someone from NASD could speak directly to this problem, I am not aware there is a requirement that a capital withdrawal be reported.

Of course the firm must stay in capital compliance at all times. When it falls below that or it gets dangerously low, this information goes to the self-regulators and to the SEC.

Mr. OWENS. Of course, Mr. Chairman, as you well know, one of the worries along with the back office problem in those hectic days to which you have alluded was also the impermanency and the instability of the capital structure of many of the firms.

I think in large measure that has been taken care of. Since that time, too, a number of firms have gone public, as you well know.

Senator WILLIAMS. Yes. Now you will be handling, under this act, them yourselves. This will be a new activity for you. Have you been in preparation to accept this new responsibility?

Mr. OWENS. Yes, we have, Mr. Chairman. As I mentioned in my prepared remarks, we have acted as trustee in five liquidations. We have asked permission of the courts to do so in additional smaller cases. But some courts have been reluctant to grant us this authority, because it is not expressed in the act.

Some courts may have felt that there is a problem with respect to the statutory requirement of disinterestedness if a SIPC employee is appointed to act as a trustee.

I think, myself, that that problem is not real. But nonetheless some courts may have felt this.

So these amendments give us specific authority. Based upon the experience that we have had in the various liquidations in which we have had a SIPC employee serve as trustee and also based upon the fact that we have some very competent and able personnel with a high degree of expertise to act in this area, I feel it will not be a problem.

Senator WILLIAMS. Let me go through something that has reached us here in the nature of observations, critical observations in part.

As I indicated in the opening remarks, this bill is broadly supported in its present form. And your statement concedes that some of SIPC's original recommendations, such as the inclusion of mutual funds, did not emerge in the House. This and other decisions on certain issues followed years of hearings and deliberations.

Some mail I have received indicates a few issues may not have received the thorough consideration that they needed.

In a letter we received, several questions were raised and I would like to present them to you for your response. This letter will be placed in the record. But here are the questions: Section 7 of the bill would amend section 5 of the act concerning SIPC recommendations and the awarding of allowances. Under the amendment, SIPC recommendations would appear to be controlling on the court.

How do you respond to one of these letters from Mr. Jaffe, and his argument that this amendment infringes on the traditional jurisdiction of the court to decide questions about fees and allowances?

Mr. OWENS. I am going to, with your permission, Mr. Chairman, refer that question for answering to Mr. Focht, our General Counsel, who is conversant with the subject.

Senator WILLIAMS. Very good.

Mr. FOCHT. Mr. Chairman, that authority which would be granted to SIPC would be limited to those cases where there was no reasonable expectation that there would be sufficient assets in the general

estate from which to pay any reasonable allowances which were granted by the court.

In other words, the authority is limited to those liquidations where the compensation of trustees and counsel are being paid from SIPC funds.

I submit that when SIPC funds are used to pay the bill, it is appropriate to rest a good deal of confidence in SIPC's view on what is an appropriate amount to be paid.

But even in those situations, if there is a difference of opinion between the persons requesting the compensation and SIPC as to what would be an appropriate amount of compensation, the bill provides that the matter would be resolved by the court.

If there is no difference of opinion, and the compensation is to be paid by SIPC funds, SIPC's views would prevail.

If there is a difference, it would be resolved by the court.

The bill further provides that if the award of compensation will be paid for with general estate funds, because there are adequate general estate funds to pay reasonable compensation, then SIPC's views would not be final, Mr. Chairman. Rather, in such cases SIPC would express its views to the court, and the court, after giving considerable weight to SIPC's views, would decide the matter.

Senator WILLIAMS. Now is there a conflict between SIPC, interested in protecting the SIPC insurance fund, and trustees appointed to protect investors, when SIPC can in effect determine the trustee's fee?

Mr. FOCHT. SIPC can determine the trustee's fee, Mr. Chairman, only in those cases where the trustee and SIPC agree on what a reasonable fee would be.

In other words, if the trustee is requesting $40,000, and SIPC concurs that that is appropriate compensation and the payment will be coming from SIPC funds, that is what would be awarded.

If the trustee is requesting $40,000 and SIPC thinks reasonable compensation should not be over $30,000, then that matter would be submitted to the court. The court would decide what the trustee should be awarded.

Senator WILLIAMS. Another conflict that troubled our writer, and I think it is worth a little discussion, is a conflict between SIPC employees acting as trustee and as an employee of SIPC. Their loyalty would appear to be divided. Would the purposes of the act be fostered by not permitting SIPC and its employees to conduct liquidations?

Mr. OWENS. Before I let Mr. Focht answer that in detail, I would just make this observation, Mr. Chairman. And that is that in the cases in which we have had experience in that area, which I have alluded to a while ago, it has not been a problem.

Mr. FOCHT. I would submit, Mr. Chairman, that I think the record in SIPC in the 7-plus years it has now been operational will show that SIPC has always considered the interests of the customer claimant.

Understandably SIPC has been concerned that the statute is properly administered and that customer claimants are awarded only that which they are entitled to receive.

One of the problems which frankly has occurred is that almost the only time there is litigation over what a customer is entitled to receive is in those situations where SIPC believes the customer should get less than he is claiming.

If you think about it, when SIPC believes the customer should get what he is claiming, there will be no litigation, because that is what will be paid.

Indeed, Mr. Chairman, there have been a few occasions where SIPC has believed a customer should receive satisfaction of his claim as filed, but the trustee, has disagreed. In those cases the trustee has said: "Well, it is SIPC's money, and if SIPC believes the customer should get that, I am not going to fight it."

My point is that it is only when SIPC believes the customer should not be getting what he seeks that we are going to have litigation over the matter.

Further, I would point out that the record will show that in a very very large percentage of those cases which have been litigated, the cases where there has been a dispute about what the customer should get, SIPC's view has prevailed in the court as the correct interpretation of the statute.

So I think, based on our record, SIPEC's actions speak for themselves.

I would also point out that, whether the liquidation is taking place under the direct payment procedure which is envisioned by section 10 of the bill, or whether SIPC itself is serving as the trustee in a judicially supervised liquidation, a customer who has a disagreement with SIPC about what he is entitled to receive will have the right to have that disagreement resolved by a court.

This is not a situation where SIPC's views will be final. A customer can always take the matter to court and the Federal judge, after hearing all sides, will decide the matter.

Mr. Owens. Just a footnote to that, Mr. Chairman. I would say we almost always, if it is a close case, resolve the case in favor of the claimant. In those cases where we consider it to be a case that should not be paid to the claimant because he wasn't legally entitled to it, we have to take a stand on it, because, after all, we are trustees of a fund. I would say that in those cases probably we have prevailed over 95 percent of the time in the courts.

Senator Williams. These cases can come up anywhere, in any district court in the country?

Mr. Owens. They can arise in any liquidation. Sometimes they are handled by bankruptcy judges.

Senator Williams. I think that covers our inquiry. We appreciate your statement, and hope we will be able to proceed, as I promised, with dispatch.

Mr. Owens. Thank you, Mr. Chairman. Those are welcome words to our ears.

Senator Williams. Now the National Association of Securities Dealers, Mr. John R. Winsor and Mr. Frank J. Wilson.

STATEMENT OF JOHN R. WINSOR, VICE CHAIRMAN, NATIONAL ASSOCIATION OF SECURITIES DEALERS, ACCOMPANIED BY FRANK J. WILSON, SENIOR VICE PRESIDENT REGULATORY POLICY AND GENERAL COUNSEL

Mr. WINSOR. Mr. Chairman, I am John Winsor, vice chairman of the Board of Governors of the National Association of Securities Dealers, Inc., and executive vice president, Piper, Jaffray & Hopwood Inc.

It is a distinct pleasure to appear today to testify in support of H.R. 8331, which would amend the Securities Investor Protection Act of 1970. We have testified previously in behalf of this bill's predecessor, H.R. 8064, and last year we testified before the House Subcommittee on Consumer Protection and Finance of the Committee on Interstate and Foreign Commerce on another version of this bill.

At that time we expressed concern in respect to certain of its provisions. We are pleased to note that in nearly every instance our concerns have been either satisfied or the pertinent provisions have been sufficiently modified so as to allay them.

In particular, we are extremely pleased that our major objection to the proposed amendments has been resolved because the earlier proposed elimination of the exemption from SIPA for mutual funds and variable annuity dealers has been deleted from the bill. We urge the Senate to retain this exemption.

I would like to submit for the record our full statement of last year on H.R. 8331.

Senator WILLIAMS. Without objection.

Mr. WINSOR. Accompanying me today is Frank J. Wilson, senior vice president regulatory policy and general counsel of the NASD. On behalf of Mr. Wilson and his colleagues on the staff and myself and my colleagues on the Board of Governors of NASD, I should like to say we very much appreciate the job that has been done by Chairman Owens and the Directors of SIPC in administering SIPC. Certainly it has been done in the best interests of the public and of the investment industry.

[The complete statement read by Mr. Winsor submitted for the record follows:]

STATEMENT OF
JOHN R. WINSOR, VICE CHAIRMAN
OF THE
BOARD OF GOVERNORS
OF THE
NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.
TO THE
SUBCOMMITTEE ON SECURITIES
OF THE
SENATE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
ON
H.R. 8331 - SECURITIES INVESTOR PROTECTION ACT AMENDMENTS OF 1977

April 25, 1978

Mr. Chairman and members of the Subcommittee, I am John R. Winsor, Vice Chairman of the Board of Governors of the National Association of Securities Dealers, Inc. and Executive Vice President, Piper, Jaffray & Hopwood Incorporated. It is a distinct pleasure to appear today to testify in support of H.R. 8331, which would amend the Securities Investor Protection Act of 1970 (SIPA). We have testified previously in behalf of this bill's predecessor, H.R. 8064, and last year we testified before the House Subcommittee on Consumer Protection and Finance of the Committee on Interstate and Foreign Commerce on another version of this bill. At that time we expressed concern in respect to certain of its provisions. We are pleased to note that in nearly every instance our concerns have been either satisfied or the pertinent provisions have been sufficiently modified so as to allay them. In particular, we are extremely pleased that our major objection to the proposed amendments has been resolved because the earlier proposed elimination of the exemption from SIPA for mutual funds and variable annuity dealers has been deleted from the bill. We urge the Senate to retain this exemption. I would like to submit for the record our full statement of last year on H.R. 8331. Accompanying me today is Frank J. Wilson, Senior Vice President Regulatory Policy and General Counsel of the NASD.

Last year we noted that the proposed amendments would do much to streamline and make more efficient the protection to public investors originally envisaged by Congress. We continue to believe that these innovative provisions are a distinct improvement to the original Act; hence we strongly support and heartily endorse the bill and urge its rapid adoption. As I noted above, we objected strenuously to the elimination of the present exclusion from SIPC membership for those broker/dealers engaged exclusively in the distribution of mutual funds and variable annuities, as well as those engaged in the business of rendering investment advisory services in respect to variable annuities and mutual funds. Since that provision is not part of the bill before you, I will not comment on it any further, other than to say the continued exclusion is entirely warranted by the record developed before the House Subcommittee.

Our second major objection to the proposed amendments at that time related to that section of the bill which we understood would give SIPC the power to provide for the mandatory display of signs or advertising relating to SIPC membership. That provision remains in the proposed amendments. The House Subcommittee report explains this provision as necessary to adequately notify the public of the existence or non-existence of SIPC protection. The Subcommittee cautioned, however, that it intended, under the authority conferred by the amendment, that SIPC would not impose an unreasonable burden upon its members in the implementation thereof and that the provision is designed to permit SIPC in its discretion to require its members to display in a reasonable fashion <u>only the bare minimum notice necessary</u> of their membership in SIPC. Given these constraints and assurances made by SIPC, we at this time raise no objection to the continued inclusion of the provision in the bill. We urge, however, the Subcommittee in its report to reiterate the intent behind the provision as expressed in the House Subcommittee report.

Additionally, we are very pleased to see that the bill as passed by the House has included, as recommended by SIPC's Board of Directors, an increase in the maximum amount SIPC may advance to satisfy cash claims, as distinct from claims for securities, from the present $20,000 to $40,000. We believe that such an increase is most desirable and entirely warranted as is the increase in the maximum amount of coverage for securities from $50,000 to $100,000.

Finally, in last year's statement we questioned why the definition of "security" in the original version of H.R. 8331 was proposed to be changed to eliminate the exclusion of money market instruments, thereby including in assessments on "gross revenues from the securities business" revenue emanating from money market transactions. We note that the House Subcommittee's report explains the need for it and adopts a compromise solution that will "permit SIPC to assess only that percentage of revenues which would reflect SIPC's loss experience in these securities for the preceding 5 years." We think that such an approach reflects our philosophy that assessments should be related to the risk involved and, therefore, we have no objection to this imaginative solution.

In sum, we urge prompt action on the bill before you. The potential benefits to the investing public are great. We believe, as the House Subcommittee stated in its report, the "bill would make SIPA more responsive to the reasonable expectations of public investors and would provide investors with greater protection against the financial failure of stock brokers, thereby enhancing investor confidence in the securities markets."

We appreciate the opportunity to comment on this bill, and would be glad to furnish the Subcommittee with any further information it desires or to respond to any questions.

STATEMENT OF
GORDON S. MACKLIN, PRESIDENT
NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.
TO THE
SUBCOMMITTEE ON CONSUMER PROTECTION AND FINANCE
OF THE
HOUSE COMMITTEE ON INTERSTATE AND FOREIGN COMMERCE
ON
H.R. 8331 - SECURITIES INVESTOR PROTECTION ACT AMENDMENTS OF 1977

August 1, 1977

Mr. Chairman and members of the Subcommittee, it is a distinct pleasure to appear today to testify in support of H.R. 8331, the so-called SIPC bill. Last year, we testified in behalf of its predecessor bill, H.R. 8064, during hearings held before the last Congress. Our position remains essentially the same inasmuch as we do not believe, except in certain respects discussed below, this bill is substantially different from H.R. 8064. I will, therefore, summarize the position we presented last year, comment upon two new provisions, and then be pleased to answer such questions as the Subcommittee may have. In addition, I would like to submit for the record our full statement of last year which expands on certain of our views in greater detail. Accompanying me today is Frank J. Wilson, Senior Vice President Regulatory Policy and General Counsel.

Last year, we stated that with two major exceptions, we supported the bill in its entirety. We noted that the proposed bill would do much to streamline and make more efficient the protection to public investors originally envisaged by Congress. We believed then, and still do, that the many innovative provisions contained therein admirably deal with many complex legal and financial problems.

Nevertheless, we must object most strongly, as we did last year, to the elimination of the present exclusions from SIPC membership for those broker/dealers engaged exclusively in the distribution of mutual funds and variable annuities, as well as those engaged in the business of rendering investment advisory services in respect to variable annuities and mutual funds. As we said last year, we know of no failures by these limited risk firms. We also strongly oppose elimination of the exclusion from assessable gross income of SIPC members, of that income which is derived from the distribution of mutual funds and variable annuities, as well as investment advisory income related to them. Last year, we noted that of the total claims of some forty-one million dollars, only $170,000 or .41 % of all SIPC disbursements were paid to customers for losses relating to mutual fund transactions. We have been informed that this figure remains proportionately the same and that the total amount of disbursements has risen to 53.4 million with mutual fund transactions accounting for $190,656. Again, as we did last year, we must emphasize that these small losses must be compared to what the huge additional assessment on the industry would have been if the exemption had not existed. Our statement last year noted that as of the end of 1974, additional assessments would have amounted to $5,395,209. Three additional years of assessment would significantly add to this sum.

Our second objection relates to that section of the bill which would give SIPC the power to provide for the mandatory display of signs or advertising relating to SIPC membership. SIPC has previously proposed an amendment to its By-Laws which would make mandatory the use of the official SIPC symbol in

members' offices and in certain advertising. However, that proposal was rejected by the Securities and Exchange Commission. The present bill contains provisions, with slight modifications, comparable to those of last year. We strongly oppose these provisions and refer you to our previous statement on H. R. 8064 detailing our reasons therefor. As rewritten, they would allow SIPC to require mandatory display of the SIPC logo. However, they also include the words "or shall" after the word "may" in the existing Act. Though it is unclear from the proposal, we are informed that the intent behind this proviso is to insure that if SIPC By-Laws require mandatory display of the symbol the Securities and Exchange Commission will be powerless to reject such a requirement. We can see no reason for this particular area of rulemaking to be eliminated from SEC oversight. Thus, we strongly object to these provisions.

In addition to the two objections we raised last year, we also object to the present bill's modification of the maximum amount SIPC may advance to satisfy cash claims as distinct from a claim for securities. Under Section 9(a)(1) of last year's bill which we agreed with, that amount was $40,000. However, the present version of the bill would reduce that amount to $20,000, the amount presently allowed under Section 6(f)(1) of the Act. Since the maximum amount of advances in liquidation proceedings is to be doubled from $50,000 to $100,000, we believe that allowing only $20,000 for cash claims is unfairly disproportionate to those public customers who have lost cash instead of securities. We understand

that the purpose of leaving this amount at $20,000 is to discourage the keeping of large cash balances with the broker/dealer. That assumption may not be valid, however. We note that the recommendation of the Special Task Force in this area was that the limits of SIPC protection should be raised to $125,000 per separate customer with the limits on cash claims to be raised to $50,000. The SIPC Board of Directors recommended the amounts be increased to $40,000 and $100,000. In connection with these limitations, it should be noted that of the 163 claims to date which have been over the existing limits, 106 were for cash over the $20,000 limit aggregating $1.2 million. We are informed that with a $40,000 ceiling, 96 of those claimants would have been fully satisfied at an additional cost of $900,000. In view of the fact that an industry Task Force recommended even higher limits, it would appear the industry is willing to and desirous of adding the additional protections. We recommend, therefore, that the $40,000 limit proposed by H. R. 8064 be retained in the current proposals, especially in view of the fact that the total number of firms placed in SIPC trusteeship, and the total number of customers' claims, have been significantly reduced in recent years.

We are concerned with the redefinition of "Consolidated Group" contained in proposed Section 4(i). Such would require that gross revenues from the securities business of a parent of a broker/dealer or an entity under common control with a broker/dealer are subject to assessment. If this change is interpreted to include, for example, principal transactions in a parent insurance

company's trading account (which it would appear to do when read literally with Section 16(9)(C)), we see no reason for it and believe it would be most unfair. Since we have opposed the elimination of the exemption for investment advisory services in respect to variable annuities and mutual funds we, of course, also object to inclusion of a parent's investment advisor's advisory fee in the consolidated gross revenues as the provision would appear to require. In any event, we believe this provision is very unclear and should be modified to clearly explain which revenues of which parent companies will be included. Further, we do not believe the scope of the provisions has been adequately studied and no explanation thereof has been offered at this point.

Finally, we note that the definition of security appears to have been changed to eliminate the exclusion of money market instruments, thereby including in the "gross revenues from the securities business" assessments on money market transactions of members, their parents and affiliates. We do not believe a need has been demonstrated for this added assessment, either with respect to the need for additional revenues or the losses incurred in money market transactions. Without knowing why this modification was made, we can only suggest that unless there is a demonstrated need for it, we would object to its inclusion.

We appreciate the opportunity to comment on this bill and would be glad to furnish the Subcommittee with any further information they desire.

Senator WILLIAMS. I think our record is complete. And we appreciate your statement very much, NASD. Thank you, gentlemen.

Mr. WINSOR. Thank you, Mr. Chairman.

[Thereupon, at 3:30 p.m. the hearing was adjourned.]

[Copy of H.R. 8331 and additional material received for the record follows:]

APPENDIX

95TH CONGRESS
1ST SESSION

H. R. 8331

IN THE SENATE OF THE UNITED STATES

NOVEMBER 3 (legislative day, NOVEMBER 1), 1977

Read twice and referred to the Committee on Banking, Housing, and Urban Affairs

AN ACT

To amend the Securities Investor Protection Act of 1970.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*
3 SHORT TITLE
4 SECTION 1. This Act may be cited as the "Securities
5 Investor Protection Act Amendments of 1977".
6 MEMBERSHIP OF SIPC
7 SEC. 2. (a) Section 3(a) of the Securities Investor
8 Protection Act of 1970 (15 U.S.C. 78ccc(a)) is amended
9 to read as follows:
10 "(a) CREATION AND MEMBERSHIP.—
11 "(1) CREATION.—There is hereby established a
12 body corporate to be known as the 'Securities Investor

1 Protection Corporation' (hereafter in this Act referred
2 to as 'SIPC'). SIPC shall be a nonprofit corporation
3 and shall have succession until dissolved by Act of the
4 Congress. SIPC shall—
5 "(A) not be an agency or establishment of the
6 United States Government; and
7 "(B) except as otherwise provided in this Act,
8 be subject to, and have all the powers conferred upon
9 a nonprofit corporation by, the District of Columbia
10 Nonprofit Corporation Act (D.C. Code, section
11 29-1001 and fol.).
12 "(2) MEMBERSHIP.—
13 "(A) MEMBERS OF SIPC.—SIPC shall be a
14 membership corporation the members of which shall
15 be all persons registered as brokers or dealers under
16 section 15(b) of the 1934 Act, other than—
17 "(i) persons whose principal business, in
18 the determination of SIPC, taking into account
19 business of affiliated entities, is conducted outside
20 the United States and its territories and posses-
21 sions; and
22 "(ii) persons whose business as a broker or
23 dealer consists exclusively of (I) the distribu-
24 tion of shares of registered open end investment
25 companies or unit investment trusts, (II) the

1 sale of variable annuities, (III) the business of
2 insurance, or (IV) the business of rendering
3 investment advisory services to one or more
4 registered investment companies or insurance
5 separate accounts.

6 "(B) COMMISSION REVIEW.—SIPC shall file
7 with the Commission a copy of any determination
8 made pursuant to subparagraph (A)(i). Within
9 thirty days after the date of such filing, or within
10 such longer period as the Commission may designate
11 of not more than ninety days after such date if it
12 finds such longer period to be appropriate and pub-
13 lishes its reasons for so finding, the Commission shall,
14 consistent with the public interest and the pur-
15 poses of this Act, affirm, reverse, or amend any such
16 determination of SIPC.

17 "(C) ADDITIONAL MEMBERS.—SIPC shall
18 provide by rule that persons excluded from mem-
19 bership in SIPC under subparagraph (A)(i) may
20 become members of SIPC under such conditions and
21 upon such terms as SIPC shall require by rule,
22 taking into account such matters as the availability
23 of assets and the ability to conduct a liquidation if
24 necessary.

1 "(D) DISCLOSURE.—Any broker or dealer ex-
2 cluded from membership in SIPC under subpara-
3 graph (A) (i) shall, as required by the Commission
4 by rule, make disclosures of its exclusion and other
5 relevant information to the customers of such broker
6 or dealer who are living in the United States or its
7 territories and possessions.".
8 (b) Section 3 (f) of such Act (15 U.S.C. 78ccc (f)) is
9 repealed.

10 POWERS OF SIPC

11 SEC. 3. Section 3 (b) of such Act (15 U.S.C. 78ccc
12 (b)) is amended—
13 (1) in paragraph (1), by striking out "court,
14 State, or Federal" and inserting "State, Federal, or
15 other court" in lieu thereof; and
16 (2) by striking out paragraph (3), redesignating
17 paragraphs (4) through (8) as paragraphs (5)
18 through (9), respectively, and inserting immediately
19 after paragraph (2) the following new paragraphs:
20 "(3) to adopt, amend, and repeal, by its Board of
21 Directors, such bylaws as may be necessary or appro-
22 priate to carry out the purposes of this Act, including
23 bylaws relating to—
24 "(A) the conduct of its business; and
25 "(B) the indemnity of its directors, officers.

1 and employees (including any such person acting
2 as trustee or otherwise in connection with a liquida-
3 tion proceeding) for liabilities and expenses actually
4 and reasonably incurred by any such person in con-
5 nection with the defense or settlement of an action
6 or suit if such person acted in good faith and in a
7 manner reasonably believed to be consistent with
8 the purposes of this Act.

9 "(4) to adopt, amend, and repeal, by its Board of
10 Directors, such rules as may be necessary or appropriate
11 to carry out the purposes of this Act, including rules
12 relating to—

13 "(A) the definition of terms used in this Act,
14 other than those terms for which a definition is pro-
15 vided in section 16;

16 "(B) the procedures for the liquidation of
17 members and direct payment procedures, including
18 the transfer of customer accounts, the distribution of
19 customer property, and the advance and payment
20 of SIPC funds; and

21 "(C) the exercise of all other rights and pow-
22 ers granted to it by this Act;".

23 BOARD OF DIRECTORS

24 SEC. 4. (a) Section 3(c)(2)(C)(ii) of such Act
25 (15 U.S.C. 78ccc(c)(2)(C)(ii)) is amended by striking

1 out "associated with any" and all that follows through
2 "group" and inserting in lieu thereof "associated with a
3 broker or dealer or associated with a member of a national
4 securities exchange, within the meaning of section 3 (a) (18)
5 or section 3 (a) (21), respectively, of the 1934 Act, or simi-
6 larly associated with any self-regulatory organization or
7 other securities industry group,".
8 (b) Section 3 (c) (5) of such Act (15 U.S.C. 78ccc
9 (c) (5)) is amended to read as follows:
10 "(5) COMPENSATION.—All matters relating to
11 compensation of directors shall be as provided in the
12 bylaws of SIPC.".
13 BYLAWS AND RULES
14 SEC. 5. Section 3 (e) of such Act (15 U.S.C. 78ccc
15 (e)) is amended to read as follows:
16 "(e) BYLAWS AND RULES.—
17 "(1) PROPOSED BYLAW CHANGES.—The Board
18 of Directors of SIPC shall file with the Commission a
19 copy of any proposed bylaw or any proposed amendment
20 to or repeal of any bylaw of SIPC (hereinafter in this
21 paragraph collectively referred to as a 'proposed bylaw
22 change'), accompanied by a concise general statement
23 of the basis and purpose of such proposed bylaw change.
24 Each such proposed bylaw change shall take effect
25 thirty days after the date of the filing of a copy thereof

1 with the Commission, or upon such later date as SIPC
2 may designate or such earlier date as the Commission
3 may determine, unless—

4 "(A) the Commission, by notice to SIPC set-
5 ting forth the reasons therefor, disapproves such
6 proposed bylaw change as being contrary to the
7 public interest or contrary to the purposes of this
8 Act; or

9 "(B) the Commission finds that such proposed
10 bylaw change involves a matter of such significant
11 public interest that public comment should be ob-
12 tained, in which case it may, after notifying SIPC
13 in writing of such finding, require that the proce-
14 dures set forth in paragraph (2) be followed with
15 respect to such proposed bylaw change, in the same
16 manner as if such proposed bylaw change were a
17 proposed rule change within the meaning of such
18 paragraph.

19 "(2) PROPOSED RULE CHANGES.—

20 "(A) FILING OF PROPOSED RULE CHANGES.—
21 The Board of Directors of SIPC shall file with the
22 Commission, in accordance with such rules as the
23 Commission may prescribe, a copy of any proposed
24 rule or any proposed amendment to or repeal of any
25 rule of SIPC (hereinafter in this subsection col-

1 lectively referred to as a 'proposed rule change'),
2 accompanied by a concise general statement of the
3 basis and purpose of such proposed rule change. The
4 Commission shall, upon the filing of any proposed
5 rule change, publish notice thereof, together with
6 the terms of substance of such proposed rule change
7 or a description of the subjects and issues involved.
8 The Commission shall give interested persons an
9 opportunity to submit written data, views, and argu-
10 ments with respect to such proposed rule change.
11 No proposed rule change shall take effect unless
12 approved by the Commission or otherwise permitted
13 in accordance with the provisions of this paragraph.

14 "(B) ACTION BY THE COMMISSION.—Within
15 thirty-five days after the date of publication of
16 notice of the filing of a proposed rule change, or
17 within such longer period as the Commission may
18 designate of not more than ninety days after such
19 date if it finds such longer period to be appropriate
20 and publishes its reasons for so finding, or as to
21 which SIPC consents, the Commission shall—

22 "(i) by order approve such proposed rule
23 change; or

24 "(ii) institute proceedings to determine

1 whether such proposed rule change should be
2 disapproved.
3 "(C) PROCEEDINGS.—Proceedings instituted
4 with respect to a proposed rule change pursuant to
5 subparagraph (B) (ii) shall include notice of the
6 grounds for disapproval under consideration and
7 opportunity for hearing, and shall be concluded
8 within one hundred eighty days after the date of
9 publication of notice of the filing of such proposed
10 rule change. At the conclusion of such proceedings,
11 the Commission shall, by order, approve or dis-
12 approve such proposed rule change. The Commis-
13 sion may extend the time for conclusion of such
14 proceedings for not more than sixty days if it finds
15 good cause for such extension and publishes its
16 reasons for so finding, or for such longer period as
17 to which SIPC consents.
18 "(D) GROUNDS FOR APPROVAL OR DIS-
19 APPROVAL.—The Commission shall approve a pro-
20 posed rule change if it finds that such proposed rule
21 change is in the public interest and is consistent with
22 the purposes of this Act, and any proposed rule
23 change so approved shall be given force and effect as
24 if promulgated by the Commission. The Commission

1 shall disapprove a proposed rule change if it does not
2 make the finding referred to in the preceding sen-
3 tence. The Commission shall not approve any pro-
4 posed rule change prior to thirty days after the date
5 of publication of notice of the filing thereof, unless
6 the Commission finds good cause for so doing and
7 publishes its reasons for so finding.
8 "(E) EXCEPTION.—Notwithstanding any other
9 provision of this paragraph, a proposed rule change
10 may take effect—
11 "(i) upon the date of filing with the Com-
12 mission, if such proposed rule change is desig-
13 nated by SIPC as relating solely to matters
14 which the Commission, consistent with the pub-
15 lic interest and the purposes of this subsection,
16 determines by rule do not require the procedures
17 set forth in this paragraph; or
18 "(ii) upon such date as the Commission
19 shall for good cause determine. Any proposed
20 rule change which takes effect under this clause
21 shall be filed promptly thereafter and reviewed
22 in accordance with the provisions of subpara-
23 graph (A).
24 At any time within sixty days after the date of
25 filing of any rule change which has taken effect

1 pursuant to this subparagraph, the Commission may
2 summarily abrogate such rule change and require
3 that it be refiled and reviewed in accordance with
4 the provisions of this paragraph, if the Commission
5 finds that such action is necessary or appropriate in
6 the public interest, for the protection of investors, or
7 otherwise in furtherance of the purposes of this Act.
8 Any action of the Commission pursuant to the pre-
9 ceding sentence shall not affect the validity or force
10 of a rule change during the period it was in effect
11 and shall not be reviewable under section 25 of the
12 1934 Act or deemed to be final agency action for
13 purposes of section 704 of title 5, United States
14 Code.

15 "(3) ACTION REQUIRED BY COMMISSION.—The
16 Commission may, by such rules as it determines to be
17 necessary or appropriate in the public interest or to
18 carry out the purposes of this Act, require SIPC to
19 adopt, amend, or repeal any SIPC bylaw or rule,
20 whenever adopted.".

21 SIPC FUND

22 SEC. 6. (a) Section 4(a) of such Act (15 U.S.C.
23 78ddd(a)) is amended—

24 (1) in paragraph (2), by striking out "The" and

1 inserting in lieu thereof "Except as otherwise provided
2 in this section, the";
3 (2) by amending paragraph (2) (C) to read as
4 follows:
5 "(C) Such confirmed lines of credit as SIPC
6 may from time to time maintain, other than those
7 maintained pursuant to paragraph (4)."; and
8 (3) by adding at the end thereof the following new
9 paragraph:
10 "(4) OTHER LINES.—SIPC may maintain such
11 other confirmed lines of credit as it considers necessary
12 or appropriate, and such other confirmed lines of credit
13 shall not be included in the balance of the fund, but
14 amounts received from such lines of credit may be dis-
15 bursed by SIPC under this Act as though such amounts
16 were part of the fund.".
17 (b) Section 4(c) of such Act (15 U.S.C. 78ddd(c))
18 is amended—
19 (1) by striking out "or rule" each place it appears;
20 and
21 (2) in paragraph (3), by striking out "(other
22 than section 3(f))".
23 (c) Section 4(d)(1) of such Act (15 U.S.C. 78ddd
24 (d)(1)) is amended by adding at the end thereof the
25 following new subparagraph:

1 "(C) MINIMUM ASSESSMENT.—The minimum
2 assessment imposed upon each member of SIPC
3 shall be $25 per annum through the year ending
4 December 31, 1979, and thereafter shall be the
5 amount from time to time set by SIPC bylaw, but
6 in no event shall the minimum assessment be greater
7 than $150 per annum.".
8 (d) Section 4(e) of such Act (15 U.S.C. 78ddd(e))
9 is amended—
10 (1) by amending paragraph (2) to read as
11 follows:
12 "(2) OVERPAYMENTS.—To the extent that any
13 payment by a member exceeds the maximum rate per-
14 mitted by subsection (c) of this section, the excess shall
15 be recoverable only against future payments by such
16 member, except as otherwise provided by SIPC
17 bylaw."; and
18 (2) by amending paragraph (3) to read as
19 follows:
20 "(3) UNDERPAYMENTS.—If a member fails to pay
21 when due all or any part of an assessment made upon
22 such member, the unpaid portion thereof shall bear in-
23 terest at such rate as may be determined by SIPC by-
24 law and, in addition to such interest, SIPC may impose
25 such penalty charge as may be determined by SIPC by-

1 law. Any such penalty charge imposed upon a SIPC
2 member shall not exceed 25 per centum of any unpaid
3 portion of the assessment. SIPC may waive such pen-
4 alty charge in whole or in part in circumstances where
5 it considers such waiver appropriate.".
6 (e) Section 4 (f) of such Act (15 U.S.C. 78ddd (f))
7 is amended by striking out "examining authority as".
8 (f) Section 4 (g) of such Act (15 U.S.C. 78ddd (g)) is
9 amended by striking out the last two sentences and inserting
10 in lieu thereof the following: "For the purposes of the next
11 preceding sentence, (1) the fee shall be based upon the
12 total dollar amount of each purchase; (2) the fee shall not
13 apply to any purchase on a national securities exchange or in
14 an over-the-counter market by or for the account of a broker
15 or dealer registered under section 15 (b) of the 1934 Act
16 unless such purchase is for an investment account of such
17 broker or dealer (and for this purpose any transfer from a
18 trading account to an investment account shall be deemed a
19 purchase at fair market value); and (3) the Commission
20 may, by rule, exempt any transaction in the over-the-counter
21 markets or on any national securities exchange where neces-
22 sary to provide for the assessment of fees on purchasers in
23 transactions in such markets and exchanges on a comparable
24 basis. Such fee shall be collected by the broker or dealer
25 effecting the transaction for or with the purchaser, or by

1 such other person as provided by the Commission by rule,
2 and shall be paid to SIPC in the same manner as assessments
3 imposed pursuant to subsection (c) but without regard to
4 the limits on such assessments, or in such other manner as the
5 Commission may by rule provide.".
6 (g) Section 4(i) of such Act (15 U.S.C. 78ddd(i))
7 is amended to read as follows:
8 "(i) CONSOLIDATED GROUP.—Except as otherwise
9 provided by SIPC bylaw, gross revenues from the securities
10 business of a member of SIPC shall be computed on a
11 consolidated basis for such member and all its subsidiaries
12 (other than the foreign subsidiaries of such member), and the
13 operations of a member of SIPC shall include those of any
14 business to which such member has succeeded.".
15 PROTECTION OF INVESTORS
16 SEC. 7. (a) Section 5(a) of such Act (15 U.S.C.
17 78eee(a)) is amended by striking out paragraphs (2)
18 and (3) and inserting in lieu thereof the following new
19 paragraphs:
20 "(2) ACTION BY SELF-REGULATORY ORGANIZA-
21 TION.—If a self-regulatory organization has given notice
22 to SIPC pursuant to subsection (a)(1) with respect to
23 a broker or dealer, and such broker or dealer undertakes
24 to liquidate or reduce its business either pursuant to the
25 direction of a self-regulatory organization or voluntarily,

1 such self-regulatory organization may render such assist-
2 ance or oversight to such broker or dealer as it considers
3 appropriate to protect the interests of customers of such
4 broker or dealer. The assistance or oversight by a self-
5 regulatory organization shall not be deemed the assump-
6 tion or adoption by such self-regulatory organization of
7 any obligation or liability to customers, other creditors,
8 shareholders, or partners of the broker or dealer, and
9 shall not prevent or act as a bar to any action by SIPC.
10 "(3) ACTION BY SIPC.—If SIPC determines
11 that—
12 "(A) any member of SIPC (including any
13 person who was a member within one hundred
14 eighty days prior to such determination) has failed
15 or is in danger of failing to meet its obligations to
16 customers; and
17 "(B) one or more of the conditions specified
18 in subsection (b)(1) exist with respect to such
19 member,
20 SIPC may, upon notice to such member, file an appli-
21 cation for a protective decree with any court of compe-
22 tent jurisdiction specified in section 21(e) or 27 of
23 the 1934 Act, except that no such application shall be
24 filed with respect to a member the only customers of

1 which are persons whose claims could not be satisfied
2 by SIPC advances pursuant to section 9.
3 "(4) EFFECT OF OTHER PENDING ACTIONS.—An
4 application with respect to a member of SIPC filed with
5 a court under paragraph (3)—
6 "(A) may, with the consent of the Commis-
7 sion, be combined with any action brought by the
8 Commission, including an action by the Commission
9 for a temporary receiver pending an appointment
10 of a trustee under subsection (b) (3); and
11 "(B) may be filed notwithstanding the pend-
12 ency in the same or any other court of any bank-
13 ruptcy, mortgage foreclosure, or equity receivership
14 proceeding or any proceeding to reorganize, con-
15 serve, or liquidate such member or its property, or
16 any proceeding to enforce a lien against property
17 of such member.".
18 (b) Section 5(b) of such Act (15 U.S.C. 78eee(b))
19 is amended to read as follows:
20 "(b) COURT ACTION.—
21 "(1) ISSUANCE OF PROTECTIVE DECREE.—Upon
22 receipt of an application by SIPC under subsection (a)
23 (3), the court shall forthwith issue a protective decree
24 if the debtor consents thereto, if the debtor fails to con-

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1 test such application, or if the court finds that such
2 debtor—
3 "(A) is insolvent within the meaning of the
4 Bankruptcy Act, or is unable to meet its obligations
5 as they mature;
6 "(B) has committed an act of bankruptcy
7 within the meaning of the Bankruptcy Act;
8 "(C) is the subject of a proceeding pending
9 in any court or before any agency of the United
10 States or any State in which a receiver, trustee, or
11 liquidator for such debtor has been appointed;
12 "(D) is not in compliance with applicable
13 requirements under the 1934 Act, or rules of the
14 Commission or any self-regulatory organization with
15 respect to financial responsibility or hypothecation
16 of customers' securities; or
17 "(E) is unable to make such computations as
18 may be necessary to establish compliance with such
19 financial responsibility or hypothecation rules.
20 Unless the debtor consents to the issuance of a protec-
21 tive decree, the application shall be heard three business
22 days after the date on which it is filed, or at such other
23 time as the court shall determine, taking into considera-
24 tion the urgency which the circumstances require.

1 "(2) Jurisdiction and powers of court.—

2 "(A) Exclusive jurisdiction.—Upon the
3 filing of an application with a court for a protective
4 decree with respect to a debtor, such court—

5 "(i) shall have exclusive jurisdiction of
6 such debtor and its property wherever located
7 (including property located outside the terri-
8 torial limits of such court and property held by
9 any other person as security for a debt or sub-
10 ject to a lien);

11 "(ii) shall have exclusive jurisdiction of
12 any suit against the trustee with respect to a
13 liquidation proceeding; and

14 "(iii) except as inconsistent with the pro-
15 visions of this Act, shall have the jurisdiction,
16 powers, and duties conferred upon a court of
17 bankruptcy by the Bankruptcy Act, together
18 with such other jurisdiction, powers, and duties
19 as are prescribed by this Act.

20 "(B) Stay of pending actions.—Pending
21 the issuance of a protective decree under paragraph
22 (1), the court with which an application has been
23 filed—

24 "(i) shall stay any pending bankruptcy,

1 mortgage foreclosure, equity receivership, or
2 other proceeding to reorganize, conserve, or
3 liquidate the debtor or its property and any
4 other suit against any receiver, conservator, or
5 trustee of the debtor or its property, and shall
6 continue such stay upon appointment of a
7 trustee pursuant to paragraph (3);
8 "(ii) may stay any proceeding to enforce
9 a lien against property of the debtor or any
10 other suit against the debtor, including a suit
11 by stockholders of the debtor which interferes
12 with prosecution by the trustee of claims against
13 former directors, officers, or employees of the
14 debtor, and may continue such stay upon ap-
15 pointment of a trustee pursuant to paragraph
16 (3);
17 "(iii) may stay enforcement of, and upon
18 appointment of a trustee pursuant to paragraph
19 (3), may continue the stay for such period of
20 time as may be appropriate, but shall not abro-
21 gate, the right of setoff provided in section 68
22 of the Bankruptcy Act, and the right to enforce
23 a valid, nonpreferential lien or pledge against
24 the property of the debtor; and

1 "(iv) may appoint a temporary receiver.
2 "(3) APPOINTMENT OF TRUSTEE AND ATTOR-
3 NEY.—If the court issues a protective decree under para-
4 graph (1), such court shall forthwith appoint, as trustee
5 for the liquidation of the business of the debtor and as
6 attorney for the trustee, such persons as SIPC, in its
7 sole discretion, specifies. The persons appointed as trustee
8 and as attorney for the trustee may be associated with
9 the same firm. SIPC may, in its sole discretion, specify
10 itself or one of its employees as trustee in any case in
11 which SIPC has determined that the liabilities of the
12 debtor to unsecured general creditors and to subordinated
13 lenders appear to aggregate less than $750,000 and
14 that there appear to be fewer than five hundred cus-
15 tomers of such debtor. No person may be appointed to
16 serve as trustee or attorney for the trustee if such person
17 is not disinterested within the meaning of paragraph
18 (6), except that for any specified purpose other than
19 to represent a trustee in conducting a liquidation pro-
20 ceeding, the trustee may, with the approval of SIPC
21 and the court, employ an attorney who is not disin-
22 terested. A trustee appointed under this paragraph shall
23 qualify by filing a bond in the manner prescribed by the
24 applicable provisions of the Bankruptcy Act, except that

1 neither SIPC nor any employee of SIPC shall be re-
2 quired to file a bond when appointed as trustee.
3 "(4) REFERENCE TO REFEREE IN BANKRUPTCY.—
4 If the court issues a protective decree and appoints a
5 trustee under this section, such court may, at any stage
6 of the proceeding, refer the proceeding to a referee in
7 bankruptcy to hear and determine any or all matters, or
8 to a referee in bankruptcy as special master to hear and
9 report generally or upon specified matters. Only under
10 special circumstances shall a reference be made to a spe-
11 cial master who is not a referee in bankruptcy.
12 "(5) COMPENSATION FOR SERVICES AND REIM-
13 BURSEMENT OF EXPENSES.—
14 "(A) ALLOWANCES IN GENERAL.—The court
15 shall grant reasonable compensation for services
16 rendered and reimbursement for proper costs and
17 expenses incurred (hereinafter in this paragraph re-
18 ferred to as 'allowances') by a trustee, and by the
19 attorney for such a trustee, in connection with a
20 liquidation proceeding. No allowances (other than
21 reimbursement for proper costs and expenses in-
22 curred) shall be granted to SIPC or any employee
23 of SIPC for serving as trustee. Allowances may be
24 granted on an interim basis during the course of the
25 liquidation proceeding at such times and in such
26 amounts as the court considers appropriate.

"(B) ALLOWANCES TO REFEREE IN BANKRUPTCY OR SPECIAL MASTER.—In the event a proceeding has been referred to a referee in bankruptcy or special master, the district judge may grant reasonable allowances to such referee in bankruptcy or a special master, in the manner provided for in a case filed under chapter X of the Bankruptcy Act, as now in effect or as amended from time to time.

"(C) APPLICATION FOR ALLOWANCES.—Any person seeking allowances shall file with the court an application which complies in form and content with the provisions of the Bankruptcy Act governing applications for allowances under such Act. A copy of such application shall be served upon SIPC when filed. The court shall fix a time for a hearing on such application, and notice of such hearing shall be given to the applicant, the trustee, the debtor, the creditors, SIPC, and such other persons as the court may designate, except that notice need not be given to customers whose claims have been or will be satisfied in full or to creditors who cannot reasonably be expected to receive any distribution during the course of the liquidation proceeding.

"(D) RECOMMENDATIONS OF SIPC AND AWARDING OF ALLOWANCES.—Whenever an application for allowances is filed pursuant to subpara-

graph (C), SIPC shall file its recommendation with respect to such allowances with the court prior to the hearing on such application and shall, if it so requests, be allowed a reasonable time after such hearing within which to file a further recommendation. In any case in which such allowances are to be paid by SIPC without reasonable expectation of recoupment thereof as provided in this Act and there is no difference between the amounts requested and the amounts recommended by SIPC, the court shall award the amounts recommended by SIPC. In determining the amount of allowances in all other cases, the court shall give due consideration to the nature, extent, and value of the services rendered, and shall place considerable reliance on the recommendation of SIPC.

"(E) Applicable restrictions.—The restrictions on sharing of compensation set forth in the Bankruptcy Act shall apply to allowances.

"(F) Charge against estate.—Allowances granted by the court, including interim allowances, shall be charged against the general estate of the debtor as a cost and expense of administration. If the general estate is insufficient to pay allowances in whole or in part, SIPC shall advance such funds as are necessary for such payment.

1 "(6) DISINTERESTEDNESS.—

2 "(A) STANDARDS.—For purposes of para-

3 graph (3), a person shall not be deemed disinter-

4 ested if—

5 "(i) such person is a creditor (including

6 a customer), stockholder, or partner of the

7 debtor;

8 "(ii) such person is or was an underwriter

9 of any of the outstanding securities of the debtor

10 or within five years prior to the filing date was

11 the underwriter of any securities of the debtor;

12 "(iii) such person is, or was within two

13 years prior to the filing date, a director, partner,

14 officer, or employee of the debtor or such an

15 underwriter, or an attorney for the debtor or

16 such an underwriter; or

17 "(iv) it appears that such person has, by

18 reason of any other direct or indirect relation-

19 ship to, connection with, or interest in the

20 debtor or such an underwriter, or for any other

21 reason, an interest materially adverse to the in-

22 terests of any class of creditors (including cus-

23 tomers) or stockholders,

24 except that SIPC shall in all cases be deemed dis-

25 interested, and an employee of SIPC shall be

1 deemed disinterested if such employee would, except
2 for his association with SIPC, meet the standards
3 set forth in this subparagraph.
4 "(B) HEARING.—The court shall fix a time for
5 a hearing on disinterestedness, to be held promptly
6 after the appointment of a trustee. Notice of such
7 hearing shall be mailed at least ten days prior
8 thereto to each person who, from the books and
9 records of the debtor, appears to have been a custo-
10 mer of the debtor with an open account within the
11 past twelve months, to the address of such person
12 as it appears from the books and records of the
13 debtor, and to the creditors and stockholders of the
14 debtor, to SIPC, and to such other persons as the
15 court may designate. The court may, in its discre-
16 tion, also require that notice be given by publication
17 in such newspaper or newspapers of general circula-
18 tion as it may designate. At such hearing, at any
19 adjournment thereof, or upon application, the court
20 shall hear objections to the retention in office of a
21 trustee or attorney for a trustee on the grounds that
22 such person is not disinterested.".
23 (c) Section 5 of such Act (15 U.S.C. 78eee) is
24 amended by adding at the end thereof the following new
25 subsection:

1 "(d) SIPC PARTICIPATION.—SIPC shall be deemed
2 to be a party in interest as to all matters arising in a liquida-
3 tion proceeding, with the right to be heard on all such
4 matters, and shall be deemed to have intervened with respect
5 to all such matters with the same force and effect as if a
6 petition for such purpose had been allowed by the court.".

7 GENERAL PROVISIONS OF A LIQUIDATION PROCEEDING

8 SEC. 8. Section 6 of such Act (15 U.S.C. 78fff) is
9 amended to read as follows:

10 **"SEC. 6. GENERAL PROVISIONS OF A LIQUIDATION PRO-**
11 **CEEDING.**

12 "(a) PURPOSES.—The purposes of a liquidation pro-
13 ceeding under this Act shall be—
14 "(1) as promptly as possible after the appointment
15 of a trustee in such liquidation proceeding, and in ac-
16 cordance with the provisions of this Act—
17 "(A) to deliver customer name securities to or
18 on behalf of the customers of the debtor entitled
19 thereto as provided in section 8(c)(2); and
20 "(B) to distribute customer property and (in
21 advance thereof or concurrently therewith) other-
22 wise satisfy net equity claims of customers to the
23 extent provided in this section;
24 "(2) to sell or transfer offices and other productive
25 units of the business of the debtor;

1 "(3) to enforce rights of subrogation as provided
2 in this Act; and
3 "(4) to liquidate the business of the debtor.
4 "(b) APPLICATION OF BANKRUPTCY ACT.—To the
5 extent consistent with the provisions of this Act, a liquida-
6 tion proceeding shall be conducted in accordance with, and
7 as though it were being conducted under, the Bankruptcy
8 Act. For purposes of applying the Bankruptcy Act to this
9 Act, any reference in the Bankruptcy Act to the date of
10 commencement of proceedings under the Bankruptcy Act
11 shall be deemed to be a reference to the filing date under
12 this Act.
13 "(c) DETERMINATION OF CUSTOMER STATUS.—In a
14 liquidation proceeding under this Act, whenever a person
15 has acted with respect to cash or securities with the debtor
16 after the filing date and in a manner which would have
17 given him the status of a customer with respect to such cash
18 or securities had the action occurred prior to the filing date,
19 and the trustee is satisfied that such action was taken by the
20 customer in good faith and prior to the appointment of the
21 trustee, the date on which such action was taken shall be
22 deemed to be the filing date for purposes of determining the
23 net equity of such customer with respect to such cash or
24 securities.

1 "(d) APPORTIONMENT.—In a liquidation proceeding
2 under this Act, any cash or securities remaining after the
3 liquidation of a lien or pledge made by a debtor shall be
4 apportioned between his general estate and customer prop-
5 erty in the proportion in which the general property of the
6 debtor and the cash and securities of the customers of such
7 debtor contributed to such lien or pledge. Securities appor-
8 tioned to the general estate under this subsection shall be
9 subject to the provisions of section 16(5) (A).

10 "(e) COSTS AND EXPENSES OF ADMINISTRATION.—
11 All costs and expenses of administration of the estate of the
12 debtor and of the liquidation proceeding shall be borne by
13 the general estate of the debtor to the extent it is sufficient
14 therefor, and the priorities of distribution from the general
15 estate shall be as provided in the Bankruptcy Act. Costs and
16 expenses of administration shall include payments pursuant
17 to section 8(e) and section 9(c) (1) (to the extent such
18 payments recovered securities which were apportioned to
19 the general estate pursuant to subsection (d)) and costs and
20 expenses of SIPC employees utilized by the trustee pursuant
21 to section 7(a) (2). All funds advanced by SIPC to a
22 trustee for such costs and expenses of administration shall
23 be recouped from the general estate as a first priority under
24 the Bankruptcy Act.".

1 NEW SECTIONS OF THE SECURITIES INVESTOR PROTECTION
2 ACT OF 1970

3 SEC. 9. The Securities Investor Protection Act of 1970
4 (15 U.S.C. 78aaa et seq.) is amended by redesignating sec-
5 tions 7 through 12 as sections 11 through 16, respectively,
6 and by inserting immediately after section 6 the following
7 new sections:

8 "SEC. 7. POWERS AND DUTIES OF A TRUSTEE.

9 "(a) TRUSTEE POWERS.—A trustee shall be vested
10 with the same powers and title with respect to the debtor and
11 the property of the debtor, including the same rights to
12 avoid preferences, as a trustee in bankruptcy under the
13 Bankruptcy Act has with respect to a bankrupt and the
14 property of a bankrupt. In addition, a trustee may, with the
15 approval of SIPC but without any need for court approval—

16 "(1) hire and fix the compensation of all personnel
17 (including officers and employees of the debtor and of
18 its examining authority) and other persons (including
19 accountants) that are deemed by the trustee necessary
20 for all or any purposes of the liquidation proceeding;

21 "(2) utilize SIPC employees for all or any purposes
22 of a liquidation proceeding; and

23 "(3) margin and maintain customer accounts of
24 the debtor for the purposes of section 8 (f).

25 "(b) TRUSTEE DUTIES.—To the extent consistent with

1 the provisions of this Act or as otherwise ordered by the
2 court, a trustee shall be subject to the same duties as a
3 trustee in bankruptcy, except that a trustee may, but shall
4 have no duty to, reduce to money any securities constituting
5 customer property or in the general estate of the debtor.
6 In addition, the trustee shall—
7 "(1) deliver securities to or on behalf of customers
8 to the maximum extent practicable in satisfaction of
9 customer claims for securities of the same class and series
10 of an issuer; and
11 "(2) subject to the prior approval of SIPC but
12 without any need for court approval, pay or guarantee
13 all or any part of the indebtedness of the debtor to
14 a bank, lender, or other person if the trustee deter-
15 mines that the aggregate market value of securities
16 to be made available to the trustee upon the payment
17 or guarantee of such indebtedness does not appear to
18 be less than the total amount of such payment or
19 guarantee.
20 "(c) REPORTS BY TRUSTEE TO COURT.—The trustee
21 shall make to the court and to SIPC such written reports
22 as may be required by the Bankruptcy Act, and shall in-
23 clude in such reports information with respect to the progress
24 made in distributing cash and securities to customers. Such
25 reports shall be in such form and detail as the Commission

1 determines by rule to present fairly the results of the liquida-
2 tion proceeding as of the date of or for the period covered
3 by such reports, having due regard for the requirements of
4 section 17 of the 1934 Act and the rules prescribed under
5 such section and the magnitude of items and transactions
6 involved in connection with the operations of a broker
7 or dealer.

8 "(d) INVESTIGATIONS.—The trustee shall—

9 "(1) as soon as practicable, investigate the acts,
10 conduct, property, liabilities, and financial condition of
11 the debtor, the operation of its business, and any other
12 matter, to the extent relevant to the liquidation proceed-
13 ing, and report thereon to the court;

14 "(2) examine, by deposition or otherwise, the di-
15 rectors and officers of the debtor and any other witnesses
16 concerning any of the matters referred to in para-
17 graph (1);

18 "(3) report to the court any facts ascertained by
19 the trustee with respect to fraud, misconduct, misman-
20 agement, and irregularities, and to any causes of action
21 available to the estate; and

22 "(4) as soon as practicable, prepare and submit, to
23 SIPC and such other persons as the court designates and
24 in such form and manner as the court directs, a statement

1 of his investigation of matters referred to in paragraph
2 (1).

3 "SEC. 8. SPECIAL PROVISIONS OF A LIQUIDATION PRO-
4 CEEDING.

5 "(a) NOTICE AND CLAIMS.—

6 "(1) NOTICE OF PROCEEDINGS.—Promptly after
7 the appointment of the trustee, such trustee shall cause
8 notice of the commencement of proceedings under this
9 section to be published in one or more newspapers of
10 general circulation in the form and manner determined
11 by the court, and at the same time shall cause a copy
12 of such notice to be mailed to each person who, from the
13 books and records of the debtor, appears to have been a
14 customer of the debtor with an open account within the
15 past twelve months, to the address of such person as it
16 appears from the books and records of the debtor. Notice
17 to creditors other than customers shall be given in the
18 manner prescribed by the Bankruptcy Act, except that
19 such notice shall be given by the trustee.

20 "(2) STATEMENT OF CLAIM.—A customer shall
21 file with the trustee a written statement of claim but
22 need not file a formal proof of claim, except that no obli-
23 gation of the debtor to any person associated with the
24 debtor with the meaning of section 3(a)(18) or sec-

1 tion 3 (a) (21) of the 1934 Act, any beneficial owner
2 of 5 per centum or more of the voting stock of the debtor,
3 or any member of the immediate family of any such
4 person or owner may be satisfied without formal proof of
5 claim.

6 "(3) TIME LIMITATIONS.—No claim of a customer
7 or other creditor of the debtor which is received by the
8 trustee after the expiration of the six-month period be-
9 ginning on the date of publication of notice under para-
10 graph (1) shall be allowed, except that the court may,
11 upon aplication within such period and for cause shown,
12 grant a reasonable, fixed extension of time for the filing
13 of a claim by the United States, by a State or political
14 subdivision thereof, or by an infant or incompetent per-
15 son without a guardian. Any claim of a customer for net
16 equity which is received by the trustee after the expira-
17 tion of such period of time as may be fixed by the court
18 (not exceeding sixty days after the date of publication
19 of notice under paragraph (1)) need not be paid or
20 satisfied in whole or in part out of customer property,
21 and, to the extent such claim is satisfied from moneys
22 advanced by SIPC, it shall be satisfied in cash or secu-
23 rities (or both) as the trustee determines is most eco-
24 nomical to the estate.

25 "(4) EFFECT ON CLAIMS.—Except as otherwise

1 provided in this section, and without limiting the powers
2 and duties of the trustee to discharge obligations
3 promptly as specified in this section, nothing in this sec-
4 tion shall limit the right of any person, including any
5 subrogee, to establish by formal proof or otherwise as
6 the court may provide such claims as such person may
7 have against the debtor, including claims for the pay-
8 ment of money and the delivery of specific securities,
9 without resort to moneys advanced by SIPC to the
10 trustee.

11 "(b) PAYMENTS TO CUSTOMERS.—After receipt of a
12 written statement of claim pursuant to subsection (a) (2),
13 the trustee shall promptly discharge, in accordance with the
14 provisions of this section, all obligations of the debtor to a
15 customer relating to, or net equity claims based upon, securi-
16 ties or cash, by the delivery of securities or the making of
17 payments to or for the account of such customer (subject
18 to the provisions of subsection (d) and section 9 (a)) inso-
19 far as such obligations are ascertainable from the books and
20 records of the debtor or are otherwise established to the satis-
21 faction of the trustee. For purposes of distributing securities
22 to customers, all securities shall be valued as of the close
23 of business on the filing date. For purposes of this subsection,
24 the court shall, among other things—

25 "(1) with respect to net equity claims, authorize the

1 trustee to satisfy claims out of moneys made available to
2 the trustee by SIPC notwithstanding the fact that there
3 has not been any showing or determination that there are
4 sufficient funds of the debtor available to satisfy such
5 claims; and

6 "(2) with respect to claims relating to, or net
7 equities based upon, securities of a class and series of an
8 issuer which are ascertainable from the books and
9 records of the debtor or are otherwise established to the
10 satisfaction of the trustee, authorize the trustee to deliver
11 securities of such class and series if and to the extent
12 available to satisfy such claims in whole or in part, with
13 partial deliveries to be made pro rata to the greatest
14 extent considered practicable by the trustee.

15 Any payment or delivery of property pursuant to this sub-
16 section may be conditioned upon the trustec requiring claim-
17 ants to execute, in a form to be determined by the trustee,
18 appropriate receipts, supporting affidavits, releases, and
19 assignments, but shall be without prejudice to any right of
20 a claimant to file formal proof of claim within the period
21 specified in subsection (a) (3) for any balance of securi-
22 ties or cash to which such claimant considers himself entitled.

23 "(c) CUSTOMER RELATED PROPERTY.—

24 "(1) ALLOCATION OF CUSTOMER PROPERTY.—The
25 trustee shall allocate customer property of the debtor as
26 follows:

1 "(A) first, to SIPC in repayment of advances
2 made by SIPC pursuant to section 9(c)(1), to the
3 extent such advances recovered securities which
4 were apportioned to customer property pursuant to
5 section 6(d);

6 "(B) second, to customers of such debtor, who
7 shall share ratably in such customer property on
8 the basis and to the extent of their respective net
9 equities;

10 "(C) third, to SIPC as subrogee for the claims
11 of customers;

12 "(D) fourth, to SIPC in repayment of ad-
13 vances made by SIPC pursuant to section 9(c)(2).

14 Any customer property remaining after allocation in
15 accordance with this paragraph shall become part of the
16 general estate of the debtor. To the extent customer
17 property and SIPC advances pursuant to section 9(a)
18 are not sufficient to pay or otherwise satisfy in full the
19 net equity claims of customers, such customers shall be
20 entitled, to the extent only of their respective unsatisfied
21 net equities, to participate in the general estate as un-
22 secured creditors. For purposes of allocating customer
23 property under this paragraph, securities to be delivered
24 in payment of net equity claims for securities of the same
25 class and series of an issuer shall be valued as of the close
26 of business on the filing date.

1 "(2) DELIVERY OF CUSTOMER NAME SECURI-
2 TIES.—The trustee shall deliver customer name securities
3 to or on behalf of a customer of the debtor entitled
4 thereto if the customer is not indebted to the debtor. If
5 the customer is so indebted, such customer may, with the
6 apporval of the trustee, reclaim customer name securities
7 upon payment to the trustee, within such period of time
8 as the trustee determines, of all indebtedness of such
9 customer to the debtor.
10 "(3) RECOVERY OF TRANSFERS.—Whenever cus-
11 tomer property is not sufficient to pay in full the claims
12 set forth in subparagraphs (A) through (D) of para-
13 graph (1), the trustee may recover any property trans-
14 ferred by the debtor which, except for such transfer,
15 would have been customer property if and to the extent
16 that such transfer is voidable or void under the provisions
17 of the Bankruptcy Act. Such recovered property shall
18 be treated as customer property. For purposes of
19 such recovery, the property so transferred shall be
20 deemed to have been the property of the debtor and, if
21 such transfer was made to a customer or for his benefit,
22 such customer shall be deemed to have been a creditor,
23 the laws of any State to the contrary notwithstanding.
24 "(d) PURCHASE OF SECURITIES.—The trustee shall, to
25 the extent that securities can be purchased in a fair and

1 orderly market, purchase securities as necessary for the
2 delivery of securities to customers in satisfaction of their
3 claims for net equities based on securities under section 7
4 (b) (1) and for the transfer of customer accounts under sub-
5 section (f), in order to restore the accounts of such customers
6 as of the filing date. To the extent consistent with subsection
7 (c), customer property and moneys advanced by SIPC
8 may be used by the trustee to pay for securities so purchased.
9 Moneys advanced by SIPC for each account of a separate
10 customer may not be used to purchase securities to the extent
11 that the aggregate value of such securities on the filing date
12 exceeded the amount permitted to be advanced by SIPC
13 under the provisions of section 9 (a).

14 "(e) CLOSEOUTS.—

15 "(1) IN GENERAL.—Any contract of the debtor for
16 the purchase or sale of securities in the ordinary course
17 of its business with other brokers or dealers which is
18 wholly executory on the filing date shall not be com-
19 pleted by the trustee, except to the extent permitted by
20 SIPC rule. Upon the adoption by SIPC of rules with
21 respect to the closeout of such a contract but prior to
22 the adoption of rules with respect to the completion of
23 such a contract, the other broker or dealer shall close
24 out such contract, without unnecessary delay, in the best
25 available market and pursuant to such SIPC rules.

1 Until such time as SIPC adopts rules with respect to
2 the completion or closeout of such a contract, such a
3 contract shall be closed out in accordance with Commis-
4 sion Rule S6(d)-1 as in effect on the date of enactment
5 of this section, or any comparable rule of the Commission
6 subsequently adopted, to the extent not inconsistent with
7 the provisions of this subsection.

8 "(2) NET PROFIT OR LOSS.—A broker or dealer
9 shall net all profits and losses on all contracts closed out
10 under this subsection and—

11 "(A) if such broker or dealer shows a net profit
12 on such contracts, he shall pay such net profit to the
13 trustee; and

14 "(B) if such broker or dealer sustains a net
15 loss on such contracts, he shall be entitled to file a
16 claim against the debtor with the trustee in the
17 amount of such net loss.

18 To the extent that a net loss sustained by a broker or
19 dealer arises from contracts pursuant to which such
20 broker or dealer was acting for its own customer, such
21 broker or dealer shall be entitled to receive funds ad-
22 vanced by SIPC to the trustee in the amount of such
23 loss, except that such broker or dealer may not receive
24 more than $40,000 for each separate customer with
25 respect to whom it sustained a loss. With respect to a net

1 loss which is not payable under the preceding sentence
2 from funds advanced by SIPC, the broker or dealer shall
3 be entitled to participate in the general estate as an
4 unsecured creditor.

5 "(3) REGISTERED CLEARING AGENCIES.—Neither
6 a registered clearing agency which by its rules has an
7 established procedure for the closeout of open con-
8 tracts between an insolvent broker or dealer and its
9 participants, nor its participants to the extent such par-
10 ticipants' claims are or may be processed within the
11 registered clearing agency, shall be entitled to receive
12 SIPC funds in payment of any losses on such contracts,
13 except as SIPC may otherwise provide by rule. If such
14 registered clearing agency or its participants sustain a
15 net loss on the closeout of such contracts with the
16 debtor, they shall have the right to participate in the
17 general estate as unsecured creditors to the extent of
18 such loss. Any funds or other property owed to the
19 debtor, after the closeout of such contracts, shall be
20 promptly paid to the trustee. Rules adopted by SIPC
21 under this paragraph shall provide that in no case may
22 a registered clearing agency or its participants, to the
23 extent such participants' claims are or may be processed
24 within the registered clearing agency, be entitled to re-
25 ceive funds advanced by SIPC in an amount greater, in

14 the aggregate, than could be received by the participants
15 if such participants proceeded individually under para-
16 graphs (1) and (2).

17 "(4) DEFINITION.—For purposes of this subsection,
18 the term 'customer' does not include any person who—

19 "(A) is a broker or dealer;

20 "(B) had a claim for cash or securities which
21 by contract, agreement, or understanding, or by
22 operation of law, was part of the capital of the
23 claiming broker or dealer or was subordinated to
24 the claims of any or all creditors of such broker or
25 dealer; or

14 "(C) had a relationship of the kind specified in
15 section 9(a)(5) with the debtor.

16 A claiming broker or dealer shall be deemed to have
17 been acting on behalf of its customer if it acted as agent
18 for such customer or if it held such customer's order
19 which was to be executed as a part of its contract with
20 the debtor.

21 "(f) TRANSFER OF CUSTOMER ACCOUNTS.—In order
22 to facilitate the prompt satisfaction of customer claims and
23 the orderly liquidation of the debtor, the trustee may, pur-
24 suant to terms satisfactory to him and subject to the prior
25 approval of SIPC, sell or otherwise transfer to another mem-

1 ber of SIPC, without consent of any customer, all or any
2 part of the account of a customer of the debtor. In connection
3 with any such sale or transfer to another member of SIPC
4 and subject to the prior approval of SIPC, the trustee may—
5 "(1) waive or modify the need to file a written
6 statement of claim pursuant to subsection (a) (2) ; and
7 "(2) enter into such agreements as the trustee con-
8 siders appropriate under the circumstances to indemnify
9 any such member of SIPC against shortages of cash or
10 securities in the customer accounts sold or transferred.
11 The funds of SIPC may be made available to guarantee or
12 secure any indemnification under paragraph (2). The prior
13 approval of SIPC to such indemnification shall be condi-
14 tioned, among such other standards as SIPC may determine,
15 upon a determination by SIPC that the probable cost of any
16 such indemnification can reasonably be expected not to
17 exceed the cost to SIPC of proceeding under section 9 (a)
18 and section 9 (b).
19 **"SEC. 9. SIPC ADVANCES.**
20 "(a) ADVANCES FOR CUSTOMERS' CLAIMS.—In order
21 to provide for prompt payment and satisfaction of net equity
22 claims of customers of the debtor, SIPC shall advance to the
23 trustee such moneys, not to exceed $100,000 for each cus-
24 tomer, as may be required to pay or otherwise satisfy claims

1 for the amount by which the net equity of each customer
2 exceeds his ratable share of customer property, except that—
3 "(1) if all or any portion of the net equity claim
4 of a customer in excess of his ratable share of customer
5 property is a claim for cash, as distinct from a claim for
6 securities, the amount advanced to satisfy such claim
7 for cash shall not exceed $40,000 for each such cus-
8 tomer;
9 "(2) a customer who holds accounts with the
10 debtor in separate capacities shall be deemed to be a
11 different customer in each capacity;
12 "(3) if all or any portion of the net equity claim
13 of a customer in excess of his ratable share of customer
14 property is satisfied by the delivery of securities pur-
15 chased by the trustee pursuant to section 8(d), the
16 securities so purchased shall be valued as of the filing
17 date for purposes of applying the dollar limitations of
18 this subsection;
19 "(4) no advance shall be made by SIPC to the
20 trustee to pay or otherwise satisfy, directly or indirectly,
21 any net equity claim of a customer who is a general
22 partner, officer, or director of the debtor, a beneficial
23 owner of five per centum or more of any class of equity
24 security of the debtor (other than a nonconvertible stock
25 having fixed preferential dividend and liquidation
26 rights), a limited partner with a participation of five per

1 centum or more in the net assets or net profits of the
2 debtor, or a person who, directly or indirectly and
3 through agreement or otherwise, exercised or had the
4 power to exercise a controlling influence over the man-
5 agement or policies of the debtor; and

6 "(5) no advance shall be made by SIPC to the
7 trustee to pay or otherwise satisfy any net equity claim
8 of any customer who is a broker or dealer or bank, other
9 than to the extent that it shall be established to the satis-
10 faction of the trustee, from the books and records of the
11 debtor or from the books and records of a broker or
12 dealer or bank, or otherwise, that the net equity claim
13 of such broker or dealer or bank against the debtor arose
14 out of transactions for customers of such broker or dealer
15 or bank (which customers are not themselves a broker
16 or dealer or bank or a person described in paragraph
17 (4)), in which event each such customer of such broker
18 or dealer or bank shall be deemed a separate customer of
19 the debtor.

20 To the extent moneys are advanced by SIPC to the trustee
21 to pay or otherwise satisfy the claims of customers, in addi-
22 tion to all other rights it may have at law or in equity, SIPC
23 shall be subrogated to the claims of such customers with the
24 rights and priorities provided in this Act, except that SIPC
25 as subrogee may assert no claim against customer property

1 until after the allocation thereof to customers as provided in
2 section 8 (c).
3 "(b) OTHER ADVANCES.—SIPC shall advance to the
4 trustee—
5 "(1) such moneys as may be required to carry out
6 section 8 (e); and
7 "(2) to the extent the general estate of the debtor
8 is not sufficient to pay any and all costs and expenses of
9 administration of the estate of the debtor and of the
10 liquidation proceeding, the amount of such costs and
11 expenses.
12 "(c) DISCRETIONARY ADVANCES.—SIPC may ad-
13 vance to the trustee such moneys as may be required to—
14 "(1) pay or guarantee indebtedness of the debtor
15 to a bank, lender, or other person under section 7 (b)
16 (2);
17 "(2) guarantee or secure any indemnity under sec-
18 tion 8 (f); and
19 "(3) purchase securities under section 8 (d).
20 **"SEC. 10. DIRECT PAYMENT PROCEDURE.**
21 "(a) DETERMINATION REGARDING DIRECT PAY-
22 MENTS.—If SIPC determines that—
23 "(1) any member of SIPC (including a person
24 who was a member within one hundred eighty days
25 prior to such determination has failed or is in danger

1 of failing to meet its obligations to customers;
2 "(2) one or more of the conditions specified in
3 section 5(b)(1) exist with respect to such member;
4 "(3) the claim of each customer of the member is
5 within the limits of protection provided in section 9(a);
6 "(4) the claims of all customers of the member
7 aggregate less than $250,000;
8 "(5) the cost to SIPC of satisfying customer claims
9 under this section will be less than the cost under a
10 liquidation proceeding; and
11 "(6) such member's registration as a broker-dealer
12 under section 15(b) of the 1934 Act has been termi-
13 nated, or such member has consented to the use of the
14 direct payment procedure set forth in this section,
15 SIPC may, in its discretion, use the direct payment proce-
16 dure set forth in this section in lieu of instituting a liquida-
17 tion proceeding with respect to such member.
18 "(b) NOTICE.—Promptly after a determination under
19 subsection (a) that the direct payment procedure is to be
20 used with respect to a member, SIPC shall cause notice of
21 such direct payment procedure to be published in one or more
22 newspapers of general circulation in a form and manner
23 determined by SIPC, and at the same time shall cause to be
24 mailed a copy of such notice to each person who appears,
25 from the books and records of such member, to have been

1 a customer of the member with an open account within the
2 past twelve months, to the address of such person as it
3 appears from the books and records of such member. Such
4 notice shall state that SIPC will satisfy customer claims
5 directly, without a liquidation proceeding, and shall set forth
6 the form and manner in which claims may be presented. A
7 direct payment procedure shall be deemed to commence on
8 the date of first publication under this subsection and no
9 claim by a customer shall be paid or otherwise satisfied by
10 SIPC unless received within the six-month period begin-
11 ning on such date, except that SIPC shall, upon applica-
12 tion within such period, and for cause shown, grant a
13 reasonable, fixed extenson of time for the filing of a claim by
14 the United States, by a State or political subdivision thereof,
15 or by an infant or incompetent person without a guardian.
16 "(c) PAYMENTS TO CUSTOMERS.—SIPC shall prompt-
17 ly satisfy all obligations of the member to each of its cus-
18 tomers relating to, or net equity claims based upon, securi-
19 ties or cash by the delivery of securities or the effecting of
20 payments to such customer (subject to the provisions of sec-
21 tion 8(d) and section 9(a)) insofar as such obligations
22 are ascertainable from the books and records of the mem-
23 ber or are otherwise established to the satisfaction of SIPC.
24 For purposes of distributing securities to customers, all
25 securities shall be valued as of the close of business on the

1 date of publication under subsection (b). Any payment or
2 delivery of securities pursuant to this section may be con-
3 ditioned upon the execution and delivery, in a form to be
4 determined by SIPC, of appropriate receipts, supporting
5 affidavits, releases, and assignments. To the extent moneys
6 of SIPC are used to satisfy the claims of customers, in addi-
7 tion to all other rights it may have at law or in equity,
8 SIPC shall be subrogated to the claims of such customers
9 against the member.
10 "(d) EFFECT ON CLAIMS.—Except as otherwise pro-
11 vided in this section, nothing in this section shall limit the
12 right of any person, including any subrogee, to establish by
13 formal proof or otherwise such claims as such person may
14 have against the member, including claims for the payment
15 of money and the delivery of specific securities, without
16 resort to moneys of SIPC.
17 "(e) JURISDICTION OF DISTRICT COURTS.—After
18 SIPC has published notice of the institution of a direct pay-
19 ment procedure under this section, any person aggrieved by
20 any determination of SIPC with respect to his claim under
21 subsection (c) may, within six months following mailing by
22 SIPC of its determination with respect to such claim, seek a
23 final adjudication of such claim. The district courts of the
24 United States shall have original and exclusive jurisdiction
25 of any civil action for the adjudication of such claim, without

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1 regard to the citizenship of the parties or the amount in con-
2 troversy. Any such action shall be brought in the judicial
3 district where the head office of the debtor is located. Any
4 determination of the rights of a customer under subsection
5 (c) shall not prejudice any other right or remedy of the
6 customer against the member.

7 "(f) DISCONTINUANCE OF DIRECT PAYMENT PROCE-
8 DURES.—If, at any time after the institution of a direct pay-
9 ment procedure with respect to a member, SIPC determines,
10 in its discretion, that continuation of such direct payment
11 procedure is not appropriate, SIPC may cease such direct
12 payment procedure and, upon so doing, may seek a protective
13 decree pursuant to section 5. To the extent payments of cash,
14 distributions of securities, or determinations with respect to
15 the validity of a customer's claim are made under this section,
16 such payments, distributions, and determinations shall be
17 recognized and given full effect in the event of any subsequent
18 liquidation proceeding. Any action brought under subsection
19 (e) and pending at the time of the appointment of a trustee
20 under section 5(b)(3) shall be permanently stayed by the
21 court at the time of such appointment, and the court shall
22 enter an order directing the transfer or removal to it of such
23 suit. Upon such removal or transfer the complaint in such
24 action shall constitute the plaintiff's claim in the liquidation

1 proceeding, if appropriate, and shall be deemed received by
2 the trustee on the date of his appointment regardless of the
3 date of actual transfer or removal of such action.
4 "(g) REFERENCES.—For purposes of this section, any
5 reference to the trustee in sections 7 (b) (1), 8 (d), 8 (f),
6 9 (a), 16 (3) and 16 (12) shall be deemed a reference to
7 SIPC, and any reference to the date of publication of notice
8 under section 8 (a) shall be deemed a reference to the publi-
9 cation of notice under this section.".
10 COMMISSION FUNCTIONS
11 SEC. 10. Section 11 (a) of such Act (15 U.S.C. 78ggg
12 (a)), as redesignated by this Act, is amended by striking out
13 "or regulations pursuant to section 3 (e) and section 9 (f)"
14 and inserting "pursuant to section 3 (e) (3) and section
15 13 (f)".
16 EXAMINING AUTHORITY FUNCTIONS
17 SEC. 11. Section 12 of such Act (15 U.S.C. 78hhh),
18 as redesignated by this Act, is amended—
19 (1) by inserting ", or collection agent if a collection
20 agent has been designated pursuant to section 13 (a),"
21 immediately after "examining authority" the first place
22 it appears; and
23 (2) by inserting "or collection agent" immediately
24 after "examining authority" the second place it appears.

1 FUNCTIONS OF SELF-REGULATORY ORGANIZATIONS

2 SEC. 12. Section 13 (a) of such Act (15 U.S.C. 78iii
3 (a)) is amended to read as follows:

4 "(a) COLLECTION AGENT.—Each self-regulatory orga-
5 nization shall act as collection agent for SIPC to collect the
6 assessments payable by all members of SIPC for whom such
7 self-regulatory organization is the examining authority, unless
8 SIPC designates a self-regulatory organization other than the
9 examining authority to act as collection agent for any mem-
10 ber of SIPC who is a member of or participant in more than
11 one self-regulatory organization. If the only self-regulatory
12 organization of which a member of SIPC is a member or in
13 which it is a participant is a registered clearing agency that
14 is not the examining authority for the member, SIPC may,
15 nevertheless, designate such registered clearing agency as
16 collection agent for the member or may require that pay-
17 ments be made directly to SIPC. The collection agent shall
18 be obligated to remit to SIPC assessments made under section
19 4 only to the extent that payments of such assessment are
20 received by such collection agent. Members of SIPC who are
21 not members of or participants in a self-regulatory organiza-
22 tion shall make payments directly to SIPC.".

23 (b) Section 13 (b) of such Act (15 U.S.C. 78iii (b)),
24 as redesignated by this Act, is amended by inserting "and
25 section 5 (a) (2)" immediately after "section 5 (a) (1)".

1 (c) Section 13 (c) of such Act (15 U.S.C. 78iii (c)),
2 as redesignated by this Act, is amended to read as follows:
3 "(c) INSPECTIONS.—The self-regulatory organization
4 of which a member of SIPC is a member or in which it is a
5 participant shall inspect or examine such member for com-
6 pliance with applicable financial responsibility rules, except
7 that—
8 "(1) if the self-regulatory organization is a regis-
9 tered clearing agency, the Commission may designate
10 itself as responsible for the examination of such member
11 for compliance with applicable financial responsibility
12 rules; and
13 "(2) if a member of SIPC is a member of or partic-
14 ipant in more than one self-regulatory organization, the
15 Commission, pursuant to section 17 (d) of the 1934 Act,
16 shall designate one of such self-regulatory organizations
17 or itself as responsible for the examination of such mem-
18 ber for compliance with applicable financial responsi-
19 bility rules.".
20 (d) Section 13 (f) of such Act (15 U.S.C. 78iii (f)),
21 as redesignated by this Act, is amended to read as follows:
22 "(f) FINANCIAL CONDITION OF MEMBERS.—The Com-
23 mission may, by such rules as it determines necessary or
24 appropriate in the public interest and to carry out the pur-
25 poses of this Act, require any self-regulatory organization to

1 furnish SIPC with reports and records (or copies thereof)
2 relating to the financial condition of members of or par-
3 ticipants in such self-regulatory organization.".

4 PROHIBITED ACTS

5 SEC. 13. (a) Section 14(a) of such Act (15 U.S.C.
6 78jjj(a)), as redesignated by this Act, is amended—
7 (1) by inserting "and penalty" immediately after
8 "interest"; and
9 (2) by striking out "he" each place it appears and
10 inserting "it" in lieu thereof.
11 (b) Section 14(b) of such Act (15 U.S.C. 78jjj(b)),
12 as redesignated by this Act, is amended—
13 (1) by inserting "or for whom a direct payment
14 procedure has been initiated" immediately after "Act"
15 each place it appears; and
16 (2) in the subsection heading, by inserting "OR
17 INITIATION OF DIRECT PAYMENT PROCEDURE" im-
18 mediately after "TRUSTEE".
19 (c) Section 14(c) of such Act (15 U.S.C. 78jjj(c))
20 is amended to read as follows:
21 "(c) CONCEALMENT OF ASSETS; FALSE STATEMENTS
22 OR CLAIMS.—
23 "(1) SPECIFIC PROHIBITED ACTS.—Any person
24 who, directly or indirectly, in connection with or in con-

1 templation of any liquidation proceeding or direct pay-
2 ment procedure—
3 "(A) employs any device, scheme, or artifice
4 to defraud;
5 "(B) engages in any act, practice, or course
6 of business which operates or would operate as a
7 fraud or deceit upon any person; or
8 "(C) fraudulently or with intent to defeat this
9 Act—
10 "(i) conceals or transfers any property
11 belonging to the estate of a debtor;
12 "(ii) makes a false statement or account;
13 "(iii) presents or uses any false claim for
14 proof against the estate of a debtor;
15 "(iv) receives any material amount of
16 property from a debtor;
17 "(v) gives, offers, receives, transfers, or
18 obtains any money or property, remuneration,
19 compensation, reward, advantage, other con-
20 sideration, or promise thereof, for acting or
21 forebearing to act;
22 "(vi) conceals, destroys, mutilates, falsifies,
23 makes a false entry in, or otherwise falsifies any

1 document affecting or relating to the property
2 or affairs of a debtor; or

3 "(vii) withholds, from any person entitled
4 to its possession, any document affecting or
5 relating to the property or affairs of a debtor,
6 shall be fined not more than $50,000 or imprisoned for
7 not more than five years, or both.

8 "(2) FRAUDULENT CONVERSION.—Any person
9 who, directly or indirectly steals, embezzles, or fraudu-
10 lently, or with intent to defeat this Act, abstracts or con-
11 verts to his own use or to the use of another any of the
12 moneys, securities, or other assets of SIPC, or otherwise
13 defrauds or attempts to defraud SIPC or a trustee by
14 any means, shall be fined not more than $50,000 or
15 imprisoned not more than five years, or both.".

16 LIABILITY, ADVERTISING, AND OTHER MISCELLANEOUS
17 PROVISIONS

18 SEC. 14. (a) Section 15(d) of such Act (15 U.S.C.
19 78kkk(d)), as redesignated by this Act, is amended—

20 (1) by inserting ", officers, or employees" im-
21 mediately after "Directors"; and

22 (2) in the subsection heading, by inserting ", OF-
23 FICERS, OR EMPLOYEES" immediately after "DIREC-
24 TORS".

25 (b) Section 15(e) of such Act (15 U.S.C. 78kkk(e)),
26 as redesignated by this Act, is amended to read as follows:

1 "(e) ADVERTISING.—SIPC shall by bylaw prescribe
2 the manner in which a member of SIPC may display any
3 sign or signs (or include in any advertisement a statement)
4 relating to the protection to customers and their accounts, or
5 any other protections, afforded under this Act. No member
6 may display any such sign, or include in an advertisement
7 any such statement, except in accordance with such bylaws.
8 SIPC may also by bylaw prescribe such minimal require-
9 ments as it considers necessary and appropriate to require
10 a member of SIPC to provide public notice of its member-
11 ship in SIPC.".
12 (c) Section 15(b) of such Act (15 U.S.C. 78kkk(b)),
13 as redesignated by this Act, is repealed, and subsections (c)
14 through (h) of section 15 are redesignated as subsections
15 (b) through (g), respectively.
16 DEFINITIONS
17 SEC. 15. Section 16 of such Act (15 U.S.C. 78lll), as
18 redesignated by this Act, is amended to read as follows:
19 **"SEC. 16. DEFINITIONS.**
20 "For purposes of this Act, including the application of
21 the Bankruptcy Act to a liquidation proceeding:
22 "(1) BANKRUPTCY ACT.—The term 'Bankruptcy
23 Act' means, except where the context indicates otherwise,
24 those provisions of the Bankruptcy Act relating to ordi-
25 nary bankruptcy (chapters I through VII) as now in
26 effect or as amended from time to time, and includes the

1 rules of bankruptcy procedure promulgated with respect
2 to such provisions, but does not include the provisions of
3 section 60e of the Bankruptcy Act, relating to stock-
4 broker bankruptcies.
5 "(2) COMMISSION.—The term 'Commission' means
6 the Securities and Exchange Commission.
7 "(3) CUSTOMER.—The term 'customer' of a debtor
8 means any person (including any person with whom the
9 debtor deals as principal or agent) who has a claim on
10 account of securities received, acquired, or held by the
11 debtor in the ordinary course of its business as a broker
12 or dealer from or for the securities accounts of such per-
13 son for safekeeping, with a view to sale, to cover con-
14 summated sales, pursuant to purchases, as collateral
15 security, or for purposes of effecting transfer. The term
16 'customer' includes any person who has a claim against
17 the debtor arising out of sales or conversions of such
18 securities, and any person who has deposited cash with
19 the debtor for the purpose of purchasing securities, but
20 does not include—
21 "(A) any person to the extent that the claim
22 of such person arises out of transactions with a
23 foreign subsidiary of a member of SIPC; or
24 "(B) any person to the extent that such person
25 has a claim for cash or securities which by contract,

1 agreement, or understanding, or by operation of
2 law, is part of the capital of the debtor, or is sub-
3 ordinated to the claims of any or all creditors of
4 the debtor, notwithstanding that some ground exists
5 for declaring such contract, agreement, or under-
6 standing void or voidable in a suit between the
7 claimant and the debtor.

8 "(4) CUSTOMER NAME SECURITIES.—The term
9 'customer name securities' means securities which were
10 held for the account of a customer on the filing date by
11 or on behalf of the debtor and which on the filing date
12 were registered in the name of the customer, or were in
13 the process of being so registered pursuant to instruc-
14 tions from the debtor, but does not include securities
15 registered in the name of the customer which, by en-
16 dorsement or otherwise, were in negotiable form.

17 "(5) CUSTOMER PROPERTY.—The term 'customer
18 property' means cash and securities (except customer
19 name securities delivered to the customer) at any time
20 received, acquired, or held by or for the account of a
21 debtor from or for the securities accounts of a customer,
22 and the proceeds of any such property transferred by
23 the debtor, including property unlawfully converted.
24 The term 'customer property' includes—

25 "(A) securities held as property of the debtor

1 to the extent that the inability of the debtor to
2 meet its obligations to customers for their net equity
3 claims based on securities of the same class and
4 series of an issuer is attributable to the debtor's non-
5 compliance with the requirements of section 15 (c)
6 (3) of the 1934 Act and the rules prescribed under
7 such section;
8 "(B) resources provided through the use or
9 realization of customers' debit cash balances and
10 other customer-related debit items as defined by
11 the Commission by rule;
12 "(C) any cash or securities apportioned to
13 customer property pursuant to section 6 (d); and
14 "(D) any other property of the debtor which,
15 upon compliance with applicable laws, rules, and
16 regulations, would have been set aside or held
17 for the benefit of customers, unless the trustee deter-
18 mines that including such property within the mean-
19 ing of such term would not significantly increase
20 customer property.
21 "(6) DEBTOR.—The term 'debtor' means a mem-
22 ber of SIPC with respect to whom an application for a
23 protective decree has been filed under section 5 (a) (3)
24 or a direct payment procedure has been instituted under
25 section 10 (b).

1 "(7) EXAMINING AUTHORITY.—The term 'ex-
2 amining authority' means, with respect to any member
3 of SIPC (A) the self-regulatory organization which
4 inspects or examines such member of SIPC, or (B) the
5 Commission if such member of SIPC is not a member of
6 or participant in any self-regulatory organization or if
7 the Commission has designated itself examining author-
8 ity for such member pursuant to section 13 (c).
9 "(8) FILING DATE.—The term 'filing date' means
10 the date on which an application for a protective decree
11 is filed under section 5 (a) (3), except that—
12 "(A) if a petition was filed before such date by
13 or against the debtor under the Bankruptcy Act,
14 or under chapter X or XI of such Act, as now in
15 effect or as amended from time to time, the term
16 'filing date' means the date on which such petition
17 was filed;
18 "(B) if the debtor is the subject of a proceed-
19 ing pending in any court or before any agency of
20 the United States or any State in which a receiver,
21 trustee, or liquidator for such debtor has been ap-
22 pointed and such proceeding was commenced before
23 the date on which such application was filed, the
24 term 'filing date' means the date on which such
25 proceeding was commenced; or

1 "(C) if the debtor is the subject of a direct
2 payment procedure or was the subject of a di-
3 rect payment procedure discontinued by SIPC pur-
4 suant to section 10 (f), the term 'filing date' means
5 the date on which notice of such direct payment
6 procedure was published under section 10 (b).
7 "(9) FOREIGN SUBSIDIARY.—The term 'foreign
8 subsidiary' means any subsidiary of a member of
9 SIPC which has its principal place of business in a
10 foreign country or which is organized under the laws of
11 a foreign country.
12 "(10) GROSS REVENUES FROM THE SECURITIES
13 BUSINESS.—The term 'gross revenues from the securities
14 business' means the sum of (but without duplication)—
15 "(A) commissions earned in connection with
16 transactions in securities effected for customers as
17 agent (net of commissions paid to other brokers and
18 dealers in connection with such transactions) and
19 markups with respect to purchases or sales of securi-
20 ties as principal;
21 "(B) charges for executing or clearing trans-
22 actions in securities for other brokers and dealers;
23 "(C) the net realized gain, if any, from princi-
24 pal transactions in securities in trading accounts;
25 "(D) the net profit, if any, from the manage-

1 ment of or participation in the underwriting or dis-
2 tribution of securities;
3 "(E) interest earned on customers' securities
4 accounts;
5 "(F) fees for investment advisory services (ex-
6 cept when rendered to one or more registered invest-
7 ment companies or insurance company separate
8 accounts) or account supervision with respect to
9 securities;
10 "(G) fees for the solicitation of proxies with
11 respect to, or tenders or exchanges of, securities;
12 "(H) income from service charges or other
13 surcharges with respect to securities;
14 "(I) except as otherwise provided by rule of
15 the Commission, dividends and interest received on
16 securities in investment accounts of the broker or
17 dealer;
18 "(J) fees in connection with put, call, and
19 other option transactions in securities;
20 "(K) commissions earned from transactions
21 in (i) certificates of deposit, and (ii) Treasury
22 bills, bankers acceptances, or commercial paper
23 which have a maturity at the time of issuance of
24 not exceeding nine months, exclusive of days of
25 grace, or any renewal thereof, the maturity of which

1 is likewise limited, except that SIPC shall by by-
2 law include in the aggregate of gross revenues only
3 an appropriate percentage of such commissions
4 based on SIPC's loss experience with respect to
5 such instruments over at least the preceding five
6 years; and

7 "(L) fees and other income from such other
8 categories of the securities business as SIPC shall
9 provide by bylaw.

10 Such term does not include revenues received by a broker
11 or dealer in connection with the distribution of shares
12 of a registered open end investment company or unit
13 investment trust or revenues derived by a broker or
14 dealer from the sale of variable annuities or from the
15 conduct of the business of insurance.

16 "(11) LIQUIDATION PROCEEDING.—The term
17 'liquidation proceeding' means any proceeding for the
18 liquidation of a debtor under this Act in which a trustee
19 has been appointed under section 5(b)(3).

20 "(12) NET EQUITY.—The term 'net equity' means
21 the dollar amount of the account or accounts of a cus-
22 tomer, to be determined by—

23 "(A) calculating the sum which would have
24 been owed by the debtor to such customer if the
25 debtor had liquidated, by sale or purchase on the

1 filing date, all securities positions of such customer
2 (other than customer name securities reclaimed by
3 such customer) ; minus
4 "(B) any indebtedness of such customer to the
5 debtor on the filing date; plus
6 "(C) any payment by such customer of such
7 indebtedness to the debtor which is made with the
8 approval of the trustee and within such period as
9 the trustee may determine (but in no event more
10 than sixty days after the publication of notice under
11 section 8 (a)).
12 In determining net equity under this paragraph, accounts
13 held by a customer in separate capacities shall be deemed
14 to be accounts of separate customers.
15 "(13) PERSONS REGISTERED AS BROKERS OR
16 DEALERS.—The term 'persons registered as brokers or
17 dealers' includes any person who is a member of a
18 national securities exchange.
19 "(14) PROTECTIVE DECREE.—The term 'protective
20 decree' means a decree, issued by a court upon applica-
21 tion of SIPC under section 5 (a) (3), that the customers
22 of a member of SIPC are in need of the protection pro-
23 vided under this Act.
24 "(15) SECURITY.—The term 'security' means any
25 note, stock, treasury stock, bond, debenture, evidence of

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1 indebtedness, any collateral trust certificate, preorgani-
2 zation certificate or subscription transferable share, vot-
3 ing trust certificate, certificate of deposit, certificate of
4 deposit for a security, any investment contract or certifi-
5 cate of interest or participation in any profit-sharing
6 agreement or in any oil, gas, or mineral royalty or lease
7 (if such investment contract or interest is the subject of
8 a registration statement with the Commission pursuant
9 to the provisions of the Securities Act of 1933), any
10 certificate of interest or participation in, temporary or
11 interim certificate for, receipt for, guarantee of, or war-
12 rant or right to subscribe to or purchase or sell any of
13 the foregoing, and any other instrument commonly
14 known as a security. The term 'security' does not include
15 any currency, or any commodity or related contract or
16 futures contract, or any warrant or right to subscribe to
17 or purchase or sell any of the foregoing.".

18 AMENDMENT TO THE SECURITIES EXCHANGE ACT OF 1934

19 SEC. 16. Section 3 (a) of the Securities Exchange Act
20 of 1934 (15 U.S.C. 78c (a)) is amended by adding at the
21 end thereof the following new paragraph:
22 "(40) The term 'financial responsibility rules'
23 means the rules and regulations of the Commission or
24 the rules and regulations prescribed by any self-
25 regulatory organization relating to financial respon-

1 sibility and related practices which are designated by
2 the Commission, by rule or regulation, to be financial
3 responsibility rules.".

4 TABLE OF CONTENTS

5 Sec. 17. The table of contents of the Securities Investor
6 Protection Act of 1970 (15 U.S.C. 78aaa et seq.) is
7 amended to read as follows:

"TABLE OF CONTENTS

"Sec. 1. Short title.
"Sec. 2. Application of Securities Exchange Act of 1934.
"Sec. 3. Securities Investor Protection Corporation.
"Sec. 4. SIPC Fund.
"Sec. 5. Protection of customers.
"Sec. 6. General provisions of a liquidation proceeding.
"Sec. 7. Powers and duties of trustee.
"Sec. 8. Special provisions of a liquidation proceeding.
"Sec. 9. SIPC advances.
"Sec. 10. Direct payment procedure.
"Sec. 11. SEC functions.
"Sec. 12. Examining authority functions.
"Sec. 13. Functions of self-regulatory organizations.
"Sec. 14. Prohibited acts.
"Sec. 15. Miscellaneous provisions.
"Sec. 16. Definitions.".

Passed the House of Representatives November 1, 1977.

Attest: EDMUND L. HENSHAW, JR.,

Clerk.

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United States Senate
COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
WASHINGTON, D.C. 20510

March 9, 1978

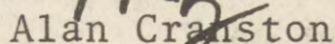
Mr. Howard Menell
Counsel for
Senate Subcommittee on Securities
A719 Immigration Building
Washington, D.C. 20510

Dear Howard,

Enclosed are materials pertaining to the Securities Investor Corporation Act by one of my constituents, Mr. Allen Mansfield. I'm forwarding them on to the subcommittee for its use during consideration of amendments to this act. I have written to Mr. Mansfield and have informed him of my actions on this matter.

With best wishes,

Sincerely,



Alan Cranston

Enclosure

THE SECURITIES INVESTOR PROTECTION CORPORATION ACT

"A CRITIQUE"

The Securities Investor Protection Corporation, (hereinafter known as SIPC) was formed at the end of 1970 by the Act passed by Congress in great haste. Action was necessary at that time, since the failures in the stock brokerage industry gave threat of a serious snowballing effect. The Act was generally an excellent Act conceived on fine principles.

It is unfortunate that many serious problems have developed concerning SIPC and this critique will summarize and analyze various law review articles which have been published concerning the Act. Congress is now considering amendments and it would seem that most Senators and Representatives are not aware of the many shortcomings that have developed and the way in which the original intent of Congress may have been perverted in the actual administration of SIPC.

The salient points are analyzed briefly below. In general, the amendments being considered by Congress are advantageous, but this is an excellent opportunity for Congress to review the entire Act in the light of what has transpired in the years of actual operation.

THE SECURITIES INVESTOR PROTECTION CORPORATION ACT

"A CRITIQUE"

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XVIII. SUMMATION

I

THE STOCK BROKERAGE INDUSTRY DOMINATES THE SIPC BOARD

The Act gave the brokerage industry practical control to begin with through the nomination of three (3) directors out of the seven (7). Naturally, the nominations have generally been from the big, powerful Wall Street firms.

However, the public is in reality not represented at all. One of the so-called public representatives is the chairman of a billion dollar trust fund whose interests run quite parallel to that of the stockbrokers. The only other public representative is Mr. Hugh Owen, the Chairman; and, unfortunately, he is not a person who will resist the overwhelming majority for the benefit of the public because of age and disposition. It would take a strong public representative to even attempt to resist these overwhelming odds.

II

THE SIPC ADMINISTRATION HAS BEEN A GHASTLY BOON-DOGGLE

It is unfortunate that in many cases the cost of administration for the trustee and his attorney alone have been more than the amount of actual claims paid to customers. This does not include the large overhead of

the SIPC central office in Washington and their staff of attorneys.

The reasons are simple, i.e. the most prestigious and expensive law firms are hired who work in tandem with the most expensive CPA firms. The practice is often to appoint a partner of the CPA firm (such as Arthur Young & Co.) as trustee and he has all the work done by his own firm. When the attorney is appointed for this trustee, it is often the largest and most expensive law firm in town, which often assigns attorneys to the case who are available (often for good reason) but not particularly qualified.

There is nothing wrong with the most prestigious law firm or the expensive CPA firm, but they are simply not needed and are not experienced in these types of operations. They immediately refuse to employ or use the help of any experienced cashiering personnel of the defunct firm and laboriously start from the beginning. This is as if the FIDC would reconstruct all the banks' books every time a failure was imminent.

There is a big difference between a high priced CPA firm and an efficient brokerage cashier. Claims could be tabulated and submitted for payment in one week by any experienced cashier instead of the three months to nine months that laborious CPA work involves.

Actually, in one case the Court was so aghast at the fees that it refused to approve them; however, few courts are this forceful. The liquidations could be carried

on for ten percent (10%) of the present cost by turning them over to people experienced in the cashiering end of the securities industry and by keeping these vultures out. A bonded experienced cashier or referee in bankruptcy can be trusted far more than the expensive prima donnas SIPC has been hiring.

III

SIPC HAS PERVERTED THE ACT BY DOMINATING THE TRUSTEES

The Act, as written by Congress, gave power to the trustee, with SIPC really performing only the passive function of supplying the money needed.

However, such has not been the case. SIPC, in the early days, appointed trustees who got into disputes with SIPC because of SIPC's refusal to pay legitimate claims. These trustees have never again been appointed and are on the SIPC blacklist. Only the trustees from the firms who follow SIPC's directions absolutely are reappointed.

Even worse, SIPC's Washington attorneys dominate the legal firms who are supposedly the trustees' attorneys. There is no question who is calling the shots. If the law firm did not follow SIPC's orders as to who to pay, they would never be reappointed.

The position SIPC takes as to their relationship to the trustee is almost humorous. On the one hand, SIPC

states that the trustee has all power and they exercise no control and in fact don't even "advise" him. Then, in the next breath, they admit that the trustee can pay no claim without their approval and in one case actually went to court to keep the trustee from paying a claim. In fact, in one case, SIPC claimed that the attorney for the trustee was SIPC's attorney (evidently because they paid him) and claimed the attorney/client privilege.

How can a trustee be "independent" when SIPC tells him which claims he can pay, and when the trustee's own paycheck comes from SIPC? Just let the trustee get out of line and note how long he waits for his money. On the West coast, one legal firm and the trustee were waiting almost a year to be paid, and they are in the good graces of SIPC. How long would they wait if they had crossed swords with SIPC?

IV

AN IRRESOLVABLE CONFLICT OF INTEREST
EXISTS UNDER THE PRESENT SIPC ACT

No insurance company ever wants to pay any claim. They do so because they have to attract future business or because the courts make them do so. Unfortunately, SIPC doesn't need to worry about attracting future insureds. They are not responsible to anyone. Further, as discussed infra, SIPC even claims that Insurance Law is "not applicable

as against itself".

Since SIPC is run by the stockbrokers who pay all of its expenses through assessments, the fewer claims paid, the lower their assessments. Thus, there is every incentive to pay fewer claims, and no incentive to liberally interpret the law Congress passed.

As an illustration, SIPC should have no need of a powerful Washington legal staff. The trustees each have their own attorneys (sometimes four or more attorneys working on one case). The SIPC is supposed to be a fair, impartial insurance company who merely establishes rules and guidelines, and advances money as needed to trustees. Where is the need of a legal battery always on call and drawing fat salaries?

The actual function of the SIPC Washington legal staff is to litigate against their own insureds. SIPC has developed a large, powerful legal staff whose function is to be the "adversary" of their own insureds. Their record has been utterly fantastic if you consider it from the point of view of not paying claims. They have, on occasions, persuaded both the Court of Appeal and Supreme Court to overrule what were decisions very much in the public interest.

As Law Review articles have pointed out, SIPC, instead of being the "protector" of the claimants, has become their "adversary", and a very vicious one. Every legal step has been to reduce payments both by interpretations that narrow the coverage of the Act and by disallowing claims.

Congress certainly showed no intent for such conduct in drafting the Act. SIPC has pushed aside the trustees who are supposed to decide claims, and has taken unto itself the job of eliminating every claim possible. In not one case have they taken the position of aiding a claimant.

In one case, SIPC threatened to "bury a claimant" in legal paperwork if he refused to accept their inadequate offer of settlement. They have succeeded in doing this with expenditures that will amount to $100,000, and this claimant has not the resources to resist them. If fact, SIPC maintains that legal expenses of successful claimants will in no case be reimbursed. They come out of his pocket, and may equal as much as the total value of his claim.

One astute Washington observer has stated that the stockbrokerage industry was forced to push the SIPC Act through in 1970 when the public was threatening in great numbers to withdraw their brokerage accounts. Now that the run has been stopped, the stockbrokerage industry wishes SIPC would dry up and go away. They don't want to pay assessments to pay off anyone's claim.

The public would have been better off to have the insurance funds used in paying their claims rather than having the very insurance company created to pay them fighting to not pay the claims, and instead spending the money on attorneys.

There is a tremendous conflict of interest when the legal staff of the Government created insurance company constantly fights with the claimants.

V

THE COVERAGE OF THE ORIGINAL SIPC ACT HAS BEEN SERIOUSLY EMASCULATED BY RULES PROMULGATED BY SIPC

It would seem from reading the Act that Congress was instituting broad coverage. However, SIPC seems to have different ideas and has apparently tried to keep from paying every claim possible.

The maximum coverage under the Act is $50,000 and that only under certain conditions. Many of the larger firms have taken out additional coverage with private companies adding on $300,000 or more of coverage. If the coverage were to be small, at least it should be dependable so that the public could trust that they would be paid.

In the following regard, the Act has been cut down as to coverage. This is a short explanation but may serve as a basis for investigation.

A

TRUSTS ARE NOT WELL COVERED UNDER THE SIPC RULES

Reading the Act, it would seem quite clear that trusts were covered (college trusts, trusts for children,

trusts under wills, non-revocable trusts, etc.). SIPC, for some reason, does not want to cover trust funds and put in a rule that a trust must have been previously filed with the brokerage company to be protected.

Since many trust documents are quite lengthy, and since many brokers do not ask for the trust document, it is the custom of most people to simply carry the trust account in a "nominee name" and not bother to file the instrument or have the shares registered in the trust name.

There would seem no valid reason for not covering these accounts since customers can usually clearly prove the existence of the trust. If the broker were negligent in obtaining all the data necessary to put in the file, it is the fault of the broker and the customer should not be punished.

There is a further serious emasculation by SIPC in trying to lump all trusts together. If a child were the beneficiary of ten (10) trusts, each having accounts of over $50,000 under SIPC's analysis, he would be limited to one coverage of $50,000. If he had a custodian or an actual cash account, this also would be thrown into the same maximum coverage so that perhaps the majority of the insurance coverage would be lost. This is plainly not the intention of Congress and not the procedure used by the FDIC and FSLC. In fact, in banks and savings and loans, they advertise for people to bring in accounts and put them under different titles to get additional coverage.

B

ACCOUNTS ARE NOT VALUED AT THE TRUE COST OF REPLACEMENT

SIPC, in pursuing its pay-the-least-amount-possible policy, has valued securities due that are traded in the over-the-counter market at the bid price. This is a custom never used by any government agency, including Inheritance Tax appriasers or the Internal Revenue Service. In most other cases, the average of the bid and asked is used.

With SIPC, the offered price (which is usually 5% to 20% higher than the bid) should be used. The reason for this is simple. The customer is being insured against loss, and his cost of replacement is the important factor. When SIPC fails to deliver a security, the customer is forced to pay the offering price plus commission to replace it.

Thus, it would seem he should at least be given the offering price, instead of the bid, and possibly should also get an allowance for commission he is going to have to pay another broker to get the stock back. The other alternative would be for SIPC to buy the security and deliver it to him. In any event, the value should be more than the bid, whereas SIPC gives less than the bid because it uses the average of all the bids, rather than the highest bid (which can always be obtained on a sale). Either the average of bid and asked should be used, or the offered price. The claimant is always penalized by SIPC.

C

ACCOUNTS ARE DELIBERATELY UNDERSTATED BECAUSE OF THE FAILURE OF THE BROKERAGE FIRM

Where the broker has been the primary market maker of an over-the-counter security, the stock is usually dependent upon the firm. When the market maker collapses, there is no longer an orderly market and the price of the stock will often plummet, sometimes losing 70% or 80% of its value.

The customer should not take this loss. If the market declines, it is due to the demise of the brokerage firm. The last price before the interruption of the market should be taken, but SIPC does not do this. In fact, in one case, SIPC took the market almost a month after the failure of the firm instead of taking a market several days prior to the failure. The prior market had been more than four times the later market, and SIPC wanted to pay the lowest possible amount.

D

OPEN CONTRACTS ARE NOT BEING COMPLETED UNDER SIPC RULES

The Act of Congress would clearly imply that all open contracts were carried out. This should mean what it says. In other words, if a customer had bought and paid

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for a security, which was being brought through another broker, he should be entitled to it as a specifically identifiable security. However, under the SIPC interpretation, the failure to deliver the stock by the other broker now cuts the customer off and he is unprotected. This is clearly an open contract which the Act says should be completed.

Further serious limitations have been placed on contracts made with <u>other brokers</u> where customers are not involved. SIPC claims these are not open contracts because only a broker was involved.

All of these SIPC imposed restrictions seriously limit the Act.

VI

THE SIPC LEGAL STAFF HAS PERVERTED THE INTENT OF CONGRESS AND THE MEANING OF THE LAW

The law as originally understood by most customers seemed fairly clear. However, SIPC by legal interpretation and numerous court cases has greatly perverted the intent of Congress. The following, as a list of interpretations and rulings is not all inclusive, but it shows this insidious technique. Following are some of the interpretations:

1. What brokerage firms are covered by SIPC insurance? (They, of course, say not all firms.)

2. Who is a customer? (The definition has been seriously narrowed.)

3. Are trust accounts covered? (SIPC says no unless procedures are followed.)

4. Are trust accounts, custodian accounts and customer accounts separate accounts, each entitled to protection? (Naturally, SIPC's answer is no.)

5. Is interest paid on delayed claims? (SIPC naturally says no, although the law says yes.)

6. Are attorneys fees reimbursed to successful claimants? (SIPC, of course, says no, although one court decided differently.)

7. Is SIPC subject to Insurance Law or "Bad Faith failure to settle" doctrine of Insurance Law? (SIPC even disclaims they are an insurance company.)

8. Is SIPC in any way similar to the FDIC or FSLC or did Congress intend any similarity? (SIPC disclaims any likeness to these excellent organizations.)

9. Does SIPC pay the court costs of claimants? (It is unheard of for a claimant in Federal Court to have to pay the costs, but such procedure is forced by SIPC.)

10. Is a claimant entitled to a jury trial? (The law would say yes, but SIPC says no.)

11. Does SIPC need to answer questions in depositions or interrogatories? (SIPC refuses to answer any questions about itself, its rules, its interpretations or its procedures.)

12. Does SIPC permit trustees to use their independent judgment? (Of course not, although SIPC gives lip service to the idea.)

13. Does the SEC interfere with SIPC's interpretations of the Act? (Congress seemed to intend this, but so far SIPC has ignored the SEC and has had the field entirely to itself.)

14. Should securities be valued at lower prices than those used by the IRS, Inheritance Tax appraisers or Insurance Companies? (As explained supra, SIPC naturally uses a lower valuation.)

15. May the law be ignored and an improper <u>date</u> be used for valuations of securities? (SIPC ignores the law as to filing date when it so desires.)

16. Are wage claims and creditors claims paid? (They were in the old days, but not under SIPC.)

17. May SIPC deliberately refuse to settle a claim for five years and then make no allowances for the loss to the customer? (Naturally. SIPC gains greatly by delaying claims.)

18. May specifically identifiable securities be forced on a customer months later when they have declined in value, and kept from him when they have gone up? (SIPC goes to great length to "identify" securities that have gone down or become worthless. The contrary is true for securities which have gone up, which are withheld whenever possible.)

These many illustrations show where SIPC's heart lies. They don't want to be fair. They are interested in saving money at the expense of customers and paying it to expensive CPA firms and legal firms.

VII

CLAIMS ARE NOT BEING SETTLED PROMPTLY, AS INTENDED BY CONGRESS

It was the intent of Congress to shortcut the bankruptcy procedures and give a quick, easy method of protecting customers. From the Congressional Record, it would appear that Congress had in mind an agency founded after the model of the FDIC or the FSLC. SIPC was to pay off security accounts at once, just as bank accounts at failed banks and savings and loan accounts are paid off by the other two agencies.

The SIPC Act, as passed by Congress, repeatedly used the word "promptly" as to payment of claims. However, after seven years of operation, there are still almost fifty percent (50%) of the failed brokerage companies whose files have not yet been closed. There are many claims as much as four and five years old. In fact, anyone who gets paid very much under a year's time is, indeed, fortunate.

The bankruptcy procedure had two shortcomings--one was the slowness and the other was the cost. Instead of cutting through the slowness problem, SIPC has, through its actions and regulations, actually superimposed another

layer on the already slow bankruptcy procedure so that it takes forever for anything to be done. This also has greatly increased the cost.

The Act indicates that the trustee appointed for a failed brokerage firm has the absolute right to pay claims and make decisions. However, in operation, the trustee must submit a report on every penny he wants to pay to SIPC in Washington who spends long period in reviewing the claims and often will not agree with the trustee's findings. If SIPC approves, the Court is then asked for approval, which takes additional time and is completely unnecessary.

SIPC is just not settling claims promptly, whereas the FDIC and FSLIC so far have never made anyone wait even for a short period. They usually settle the same day, while SIPC makes customers wait as long as five years, or more, and pays very few claims much under nine months.

VIII

THE LARGE ADMINISTRATIVE EXPENSES OF SIPC HAVE CAUSED THE RIGHTS OF CREDITORS AND WAGE EARNERS TO BE PREJUDICED

Under the Bankruptcy Act, wage earners were fairly well protected and assured of at least getting up to $600 in back wages. Creditors also had a chance of collecting something after customers of the broker were paid.

Now, the Act has completely excluded these two groups. They usually get absolutely nothing. This probably was unintentional, but SIPC has taken full advantage of its position to exclude these groups.

The cause of the exclusion is that all funds advanced by SIPC, including administrative expenses, are considered as a "priority", and are paid back to SIPC before creditors and wage earners receive anything. Since the administrative expenses are so tremendous, nothing is left for the creditors and wage earners.

In early liquidation, SIPC did pay the wage earners (the unpaid employees of the broker). For some reason, the policy was suddenly reversed and the wage earners are now left out. In fact, the trustee does not even respond to claims from these two groups, or even answer their queries.

IX

SIPC HAS EFFECTIVELY DEPRIVED MARGIN ACCOUNTS OF MOST COVERAGE

Margin accounts are very poorly covered and are not treated as cash accounts. The fault is not that of the Act (which is not too clear), but is the result of the interpretation of SIPC. It certainly was not the intent of Congress to exclude margin accounts. The emasculation of the coverage is in regard to "specifically identifiable property".

It is the custom for the broker to take margin securities to the Bank to borrow the money to advance to the client. These securities are segregated for the customers involved and SEC Rules quite clearly indicate they are the property to these customers. This should make the securities <u>specifically identifiable</u> under the Act, which means the customer gets them back in the event of the failure of the broker.

However, SIPC claims that a security is only specifically identifiable if it is in the actual <u>physical possession</u> of the broker. Since this practically never occurs in margin accounts, it means customers lose completely the coverage of specifically identifiable securities which is probably the greatest coverage provided under the Act and can far exceed the $50,000 limit.

How can a margin security be in "physical custody" of the broker when it is at the bank? It is clearly in the "possession" (at least constructive possession) of the broker, and in nearly all cases under the SEC rules, there is no question as to who is the owner. In fact, SIPC even refuses to recognize this security as specifically identifiable when it is even registered in the customer's name.

Congress meant to cover margin accounts just as cash accounts were covered. They cannot be discriminated against, but SIPC has gleefully seized on this technicality to effectively prejudice all margin accounts.

X

SIPC REFUSED TO ADMIT THAT IT IS AN INSURANCE COMPANY

For some reason and probably a very selfish one, SIPC refused to be called an insurance company. The Act plainly provides insurance coverage. In fact, many large brokers carry additional insurance coverage with private insurance companies. These policies are clearly labeled insurance.

The reason for SIPC denying its very nature as an insurance company is that insurance company law is quite strict and demanding on the insurance company. The doctrine of "bad faith failure to settle" was developed over the years to penalize insurance companies who deliberately refused to settle with a client.

There is no question that it is a great advantage to the insurance company to prolong the claim as long as possible and delay settlement. The insurance company will gain large amounts of interest by using the monies withheld from the insured. Also, it may wear the claimant down so that he will take much less to settle his claim.

Under insurance company law, these tactics are penalized by the "bad faith" doctrine. Once bad faith is established, the policy limits are no longer applicable and the insured may win a verdict for a greater amount plus interest and attorneys fees.

To illustrate, suppose a litigant has a $10,000

personal injury policy and is not paid promptly. He may be awarded a judgment running into the hundreds of thousands of dollars--whatever the jury decides. This doctrine has tended to make insurance companies much more honest and fair minded. Interest may also be added and attorneys fees awarded.

Compare this with SIPC's position. They claim they are not an insurance company so the doctrine does not apply. They claim they will pay no interest in any case. Then they claim the law says they can never pay over $50,000 in claims even though the claims may be over half a million dollars, and the interest alone in the hundreds of thousands of dollars.

Thus, SIPC has nothing to lose by stalling, litigating, wearing the claimant down, and burying him in legal fees which he must pay out of his settlement. The legal fees alone may run far more than the amount in dispute.

The poor claimant has no one to turn to. The government created insurance company is dominated by the brokers who want to pay as little in claims as possible so they may reduce the assessments on brokers. They are already saying the assessments as set by Congress are four times too high, and in fact no assessments at all are needed since the interest received by SIPC on its "kitty" will more than pay all claims.

As the Law Review articles have pointed out, SIPC has become a constant litigant against its own "insureds". They have nothing to lose by this. In fact, the longer they can refuse to pay the claim, the more money they will save because no interest is paid. The claimant against SIPC is left with no one to turn to.

Even the courts as used by SIPC effectively bar the claimant. He will need to wait for years to be heard. He will spend great sums from his own pocket in legal fees. He will get no interest or legal fees back. He is up against slick SIPC attorneys <u>and</u> Trustee attorneys (both of them) with unlimited funds and great standing with the bankruptcy judges forced to hear the cases as special master. In fact, SIPC forces the litigant to pay the court costs, even for court ordered reporters.

The courts should not be accused of favortism, but where some lowly customer is appearing in pro persona and is up against the largest, most prestigious law firm in town and the biggest CPA firm, the cards are stacked. The pompous CPA sounds like the voice of God as he states the client can't be covered. The prestigious attorney has appeared before the poor bankruptcy judge many times before. Guess who wins the case? The success ratio of SIPC in these cases is probably over 90%.

Only when actual Federal judges hear the cases and apply true insurance company law will true justice prevail. The claimants will need to be reimbursed for attorneys fees, and especially interest must be allowed for the delay. The sides must be equalized.

The situation is so bad that it is almost indescribable. One bankruptcy judge in the West who decided most of the claims in one receivership admitted that "he had never read the SIPC Act". He took the word of the trustee's attorney as to what it said. To make matters worse, the attorney inundated him with "unpublished" opinion of no validity at all in that court in an attempt to further influence him.

Thus, it is clear why SIPC claims they have nothing to do with an insurance company. They make statements they are indeed a "trust", or some nebulous semi-government organization, but the facts are plain that they are a government created, privately endowed insurance company. They should act like one.

XI

SIPC PERMITS TRUSTEES TO MAKE INCOMPLETE AND VAGUE REPORTS AND TO FAIL TO KEEP PROPER RECORDS

Once a Trustee is on SIPC's favored list, both he and the favored attorney are in fields of clover with practically no requirements as to record keeping.

There is no requirement that the attorneys keep time records which are verified and submitted for court approval as is true in bankruptcy. The trustee does not even make photocopies of the securities found in the estate of the broker. This is absolutely necessary for proof as to <u>specific</u> <u>identifiability</u>. No detailed records of time are kept.

Thus, the records so vital to customers to prove their claims are ignored, and these prestigious law and CPA firms are paid without verification. The essential record keeping is not done, prejudicing both customers, creditors and the treasury of SIPC. Creditors' claims and wage claims are not recorded, reported, or even acknowledged. The so called "status reports" are voluminous, but late and lacking in the most essential details.

XII

SIPC REFUSES TO COMPENSATE FOR FAILURE TO DELIVER CASH OR SECURITIES PROMPTLY

Let us assume a customer has made an excellent investment decision. He has saved his money and bought a security in which he has great faith.

This security was purchased shortly before the brokerage firm failed. Thus, on the date of failure, the client is due either his cash or the actual security.

In effect, the client will receive neither for many, many months, perhaps a year. If the stock was a good buy, it will start to appreciate in value. In some cases, the stocks have become worth two or three times the purchase price by the time SIPC gets around to paying out, not the stock, but the cash value at the time of the failure.

The customer has been deprived of his stock for this period. He has further been deprived of his money which would allow him to go out and rebuy the stock through another brokerage firm. This is manifestly unfair, since a customer of limited means does not have additional money to buy the stock. SIPC should be made to compensate for the delay by delivering the actual security due. In other words, there should be either interest due for the long delay, or the requirement forcing SIPC to replace the actual security at the request of the customer.

XIII

SIPC HAS REFUSED TO REIMBURSE ATTORNEY'S FEES TO CUSTOMERS

The situation is manifestly unfair when SIPC has a large and talented legal staff at its disposal with unlimited funds to spend, and the customer must pay for an expensive attorney to fight them with no change of reimbursement. In fact, it is even more unfair since often the customer must face both the trustee's attorney plus the SIPC attorney plus the CPA partners who appear as both

expert witnesses and supposed interpreters of the Act.

Under both the Securities Act of 1934 (of which the SIPC Act is an amendment) and the Bankruptcy Act (which is applicable), attorney's fees are provided for. One Court did award attorney's fees recently and the SIPC legal staff immediately appealed it to the Court of Appeal which overruled, but did remand the case. It is not clear, but apparently SIPC may have ended up paying the attorney's fees but there was no precedent and no court decision created to help others.

If the customer is forced to go to court to obtain what is rightfully his, he should receive his fees in the event of victory. So far, SIPC has refused to reimburse any fees.

Sometimes, SIPC uses their unlimited financial resources and large legal staff as a weapon. In one case, they threatened to bury a claimant if he did not accept their offer of settlement. They lived up to their threat and will expend a sum of probably $100,000 in legal fees before his case is decided and then they threaten to appeal if they lose.

An insurance company, through the bad faith doctrine, will eventually pay attorney's fees where they have forced the client to litigate to receive what is rightfully due him. This same principle clearly applies to the SIPC Act, but so far, it has been resisted.

There is an obvious need in our American Judicial System for an award for fees. Especially in these cases, many of the clients cannot afford attorneys and numerous times they have appeared at hearings in pro se only to lose to the superior SIPC legal staff and that of the trustee.

XIV

SIPC REFUSES TO PAY INTEREST ON CLAIMS

The Act is unclear and does not mention whether interest should be paid. There is no question under case law and under insurance law that interest must be paid, especially when there are liquidated amounts, but SIPC does not believe in this. A person receiving a payment of $50,000 after waiting five years had, in effect, lost at least one-third to one-half of his claim by not getting interest. If you add in inflation, his claim is wiped out, even if he finally gets his money. The present value of $50,000 is far, far more than the future value five years or more away.

There is nothing to keep SIPC from paying the interest except their desire to pay out as little as possible.

In some cases, where most of the claim is undisputed and only a portion is disputed, it is even more unfair. One poor woman customer had over $2,000 that was admittedly due her. She claimed she had over $3,000

coming; SIPC said only $2,000.

After four years, the woman prevailed and got her $3,000, but the interest loss alone plus attorney's fees probably cost her far more than the extra $1,000 she fought for.

SIPC should be given a reasonable time (perhaps thirty days) to pay the claims and interest should most certainly accrue from that time forward on all claims.

XV

SIPC HAS PERVERTED COURT PROCEDURE TO FURTHER PREJUDICE CUSTOMERS

As an example, SIPC forces a customer to pay the court reporter fees even though the court has ordered the reporter. This is absolutely unheard of and is especially curious for a company so overflowing with money they are trying to cut the insurance assessment.

Under the SIPC Act, the Federal Court has jurisdiction, but in many cases the matters are farmed out to Bankruptcy Judges who are experienced only in bankruptcy matters and perhaps not as favorably inclined to customers as an ordinary judge would be. This Bankruptcy Judge acts as a special master and SIPC immediately demands that the costs for reporters, transcripts, and probably special master's fees are to be borne by the customer.

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This is unheard of and clearly is not warranted, but is a marvelous illustration of the SIPC mentality and attitude toward its own insureds.

XVI

THE SECURITIES AND EXCHANGE COMMISSION HAS BEEN EXCLUDED BY SIPC

Congress evidently intended to place the burden of administration and interpretation of the Act on the SEC rather than on SIPC.

The SEC was called on to make rules and regulations and generally supervise matters and in fact actually bring the court actions to declare a firm in trusteeship. However, SIPC has excluded the SEC and made their position an impossible one.

The Securities and Exchange Commission is doing a wonderful job, but has many more important things to do. It is already understaffed and overworked in attempting to regulate the securities industry, not to supervise insurance.

The SEC did make some additional rules which have the effect of protecting the clients of brokerage firms, but unfortunately, these rules did not affect or help the insurance coverage. The rules provide that margin accounts must be segregated and the broker can be penalized for not segregating them. However, once the broker goes under, it is the customer who suffers, since SIPC will not pay out one

cent because of the violation by the broker and the failure to segregate.

Thus, the SEC has in most cases completely left the field of regulation and administration of the SIPC Act to SIPC itself. So far, it has done practically nothing for the public and in fact probably cannot do so without great difficulty.

It is reported that there have been some strong exchanges and arguments between the SEC and SIPC, and perhaps the SEC feels that SIPC has not lived up to what Congress intended of it, and has not provided the coverage expected.

To depend on the SEC as the Act is now set up is not possible. The public must have some means of protection since the SIPC Board is certainly broker oriented and not public oriented.

Perhaps Congress can solve this dilemma but something definitely must be done to protect the public. The brokerage industry cannot be relied on to pay claims. They don't want to pay anyone. They just want to cut their assessments for this unwanted insurance protection. It would really seem that the brokers wish the whole SIPC Act would dry up and go away.

XVII

SIPC IS SO DOMINATED BY THE INTERESTS OF THE BROKERAGE INDUSTRY THAT IT IS NOW REQUESTING THAT THE ASSESSMENTS CHARGED TO BROKERS BE REDUCED TO 25 PERCENT OF THE AMOUNT ORIGINALLY SET BY CONGRESS

SIPC has done a wonderful job of not paying out money, at least to customers. They may have wasted it on attorneys and CPAs, but the losses and payouts have not been great.

SIPC has now proposed to Congress that the rates assessed to brokers be reduced to twenty-five percent of their former amount, which was already quite low. This is a reduction to twenty-five percent, not of twenty-five percent, meaning that they want to pay only one-fourth of what Congress originally meant.

In fact, SIPC claims that the interest they are receiving on their money they have already collected will more than pay all the claims and overhead costs each year. This is, of course, a nice racket, wherein they pay out no interest to customers and collect the interest on their investments.

It must be remembered that SIPC is completely paid for by the brokerage industry. The less money that is paid out, the less will be the cost to brokers. By

holding down the payouts, this assessment will be cut back. There have been rumors that SIPC has deliberately held back on paying its bill, even to its own trustees and legal firms, in order to show as small a payout as possible until Congress considered this change.

At any rate, there is a tremendous conflict. The Board of SIPC is dominated by the brokerage industry and is mainly concerned with cutting the costs as low as possible to the brokers. By doing this, they have probably cut out many dollar claims that should have been paid to customers. But paying out the least amount possible is not always the best procedure for an insurance company and winning cases before the Court of Appeal to keep from paying people money is probably not beneficial in the end.

Although, for the moment, the brokerage industry is secure and the fund is probably as large as necessary. However, there is no question that the day may come when a larger SIPC fund is badly needed. The worst is not at all over for the market and many of the biggest firms may topple before we are out of the woods.

If there is so much money held by SIPC, instead of cutting the assessments of the brokers, why are the insurance limits not increased? That, after all, is the basis of the coverage and as long as firms are having to buy additional coverage from private companies, it shows that the coverage, if anything, is too small.

As long as the brokerage industry pays for it, there is no valid reason to reduce the assessments. The move should be toward increasing coverage, not reducing costs to brokers.

XVIII

SUMMATION

Thus, after seven years, there is a time for a sabbatical review of the SIPC Act. Many changes would seem to be indicated:

1. An elimination of the brokerage industry control of SIPC.
2. Either a replacement of the SEC as a watchdog or perhaps the creation of a SEC department with more authority to supervise SIPC.
3. An amendment of the many rules set up by SIPC to limit the coverage.
4. A clarification of the SIPC Act.
5. A provision for interest starting on the date of trusteeship.
6. A provision for attorney's fees for successful litigants.
7. A pronouncement in the Act that SIPC is an insurance company.

8. Provision for "independent" appointment of trustees by the SEC or some independent agency instead of by SIPC.

9. Elimination or reduction of SIPC's large and expensive Washington staff and especially legal staff.

10. Limitation as to total administrative expenses allowable.

11. Lowered allowable fees for trustee's attorneys and appointment of attorneys cognizant with Bankruptcy Laws.

12. Elimination of SIPC's control and domination of trustee's attorneys.

13. Elimination of SIPC's veil of secrecy and requiring them to respond to claimants' questions.

14. Fixation of assessments on brokers by Congress and provision that unused amounts go to build a larger reserve fund or be donated to the SEC for useful purposes.

15. Reimbursement of all claimants victimized by SIPC over its first seven years.

16. Elimination of costly and time consuming bankruptcy procedures and grant of power to trustee to act promptly.

17. Definition of the word "promptly" and a limitation of the time for the trustee to process the claims.

18. Requirement that all wage claims be paid ahead of SIPC reimbursement and requirement that creditors claims take precedent over SIPC reimbursement.

The Act further can be reinstated to provide what Congress had originally intended. The broad coverage, rather than the limited coverage, is what is required. Every customer of a brokerage firm should be protected.

At the present, most customers are living in a fools paradise. They assume because of the advertising by the SIPC label that they are covered, but they will find to their dismay after a brokerage firm failure that their coverage is much less than they thought.

Even at best, customers will wait a year, or maybe five or six years, They will have no attorney helping them except at their own expense and they will not receive interest. They will be up against a tough outfit ready to haggle over every penny before they pay it out.

Unfortunately, the true facts of SIPC are not known. It is only those who have come in contact with them that tell the true story. This is a very small percentage of the population. If a survey was made of those having claims with SIPC, some very enlightening facts might come forth.

Because not many people are aware of the facts, Congress has not been presented the true picture. There

has been an organized movement to push through amendments to the SIPC Act without a real review of SIPC. It is a very important time and Congress will be thankful later if a review is made now rather than at a time of panic later on.

The situation is so bad with SIPC that one trustee in California has devoted several years of his life to trying to bring this to the attention of both the public and Congress. He was one of the early trustees and is probably one of the most capable attorneys on the West Coast in bankruptcy and securities work. After his appointment as one of the trustees, he became involved in a violent dispute with SIPC who absolutely refused to pay the claims he considered as valid under the Act. Finally, after threatening to sue SIPC, he at last was allowed to pay the customers but the retribution was fast and immediate.

This trustee has never again been appointed, although he is most qualified and certainly would perform the work at one-third of the cost of the prestigious CPA firms appointed in his place.

This trustee has offered to testify before Congress, but it would seem that even if his testimony is given, it will be buried in the copious notes and really not brought to the attention of all of Congress.

Interviews with most of the SIPC trustees in Southern California show great dissatisfaction. Even the

favored ones are angry because they must wait nine months or a year to get paid. Others express very critical comments in private, but would never so testify because of losing further appointments. If Congress could get at the facts, a situation bordering on a scandal would be unearthed.

Most insureds under SIPC do not know the law or realize how they have been mistreated. There are many extremely angry, but without the means to do anything about it. The others don't realize Congress meant for them to be paid promptly, not after an interminable wait. The Law Review articles on the Act have been few, and these are conservative and not outspoken, but all are critical.

This situation is really serious and Congress will do the country a great favor to take up an in depth review of the Act after its first seven years of operation. The Law Reviews have been telling the faults of SIPC, but have done so in a modified way. Everyone is afraid to be the first one to point the accusing finger. Most people would rather avoid a fight on a controversial point.

Thus, we have a government created insurance company which is probably next in importance to the Federal Deposit Insurance Company and the Federal Savings and Loan Insurance Company. It has remained in the shadows for seven years. Only those unfortunate enough to have had dealings with SIPC have known the true story. The public has remained blissfully ignorant, resting in the thought that their securities accounts are protected by an insurance company that will settle their claims promptly (hopefully at once as the FDIC does).

Little does the public realize the true state of affairs. Even Congress has had little chance to look into the true state of affairs. When a stock panic comes, it will not be the time to look into the Act.

SIPC now comes to Congress with some innocuous amendments which are probably advantageous. The Act should be amended, and in fact badly needs amendment, but what is needed is much more.

Only Congress has the means of meeting the needs of all investors with accounts at stockbrokerage firms. A review of the entire SIPC Act is urgently needed. The original intent of Congress has been badly perverted. There is an irreconcilable conflict between the needs of investors and the administration of the Act by pawns of the stockbrokerage industry.

If Congress will but conduct an investigation and take recommendations from others than SIPC, the Act may be improved and enlarged, and once again given the real meaning intended by Congress in 1970.

The Securities Investor Protection Act of 1970 is badly in need of attention from Congress. It needs basic and far reaching amendments, and to be put in the hands of a board of directors interested in protecting the public. This is too important a corporation to be left in the hands of those with a possible conflict of interest. The reserves of cash will exceed one-fifth billion dollars. This is a matter of urgency. If the public ever again loses faith in the stockbrokerage industry, it will be too late.

American Council of Life Insurance

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(202) 862-4264

Larry M. Rosenstein
Assistant General Counsel

April 24, 1978

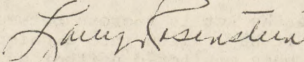
Honorable Harrison A. Williams, Jr.
Chairman
Subcommittee on Securities
Committee on Banking, Housing and
Urban Affairs
United States Senate
Washington, D. C. 20510

Dear Chairman Williams:

The American Council of Life Insurance, on behalf of its 472 life insurance company members, wishes to make known for the record its support for H.R. 8331 which would amend the Securities Investor Protection Act.

The Council and its predecessor organization, the American Life Insurance Association, have been concerned over and have opposed earlier bills which would have amended the SIPC Act because those bills would have unjustly taxed broker-dealers who sold variable contracts. The sale of these contracts, as you know, does not create the risks against which the SIPC Act was intended to insure. Because, however, H.R. 8331 does not contain these burdensome provisions and because we have been advised by the Securities Investor Protection Corporation that it supports this legislation, which was passed by the House after the above provisions were removed in Committee, we urge the passage of H.R. 8331.

Sincerely yours,



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December 20, 1977

Howard Menell, Esq.
Senate Securities Subcommittee
United States Senate Office Building
Washington, D.C.

Re: H.R. 8331, 1977 Amendments to
Securities Investor Protection Act of 1970

Dear Mr. Menell:

This letter is written on behalf of the Executive Committee of the Business and Corporations Law Section of the Los Angeles County Bar Association. Our section has several hundred members and, where appropriate, comments upon proposed legislation and rules affecting corporate and securities matters.

We are writing to present you the views of the committee with respect to the proposed amendments to the Securities Investor Protection Act of 1970 (the "Act") contained in H.R. 8331.

Preliminarily, we are concerned over the lack of attention addressed to the proposed amendments. Many of our members when apprised of H.R. 8331 were concerned that there had not been dissemination of the bill to their offices and that commentary from the corporate bar had not been solicited as is normally the case with changes in the security laws or rules enacted by the Securities and Exchange Commission ("Commission").

Since the Act is a cross between securities and bankruptcy law, it has fallen into a unique niche where its operations have been monitored neither by the bankruptcy bar nor the corporate bar. In addition, the Commission appears to have been primarily concerned with enforcement and disclosure matters, and has not, to our knowledge, established formal procedures to monitor SIPC or evaluate its approach to the Act.

We do not disagree with much of H.R. 8331. Many of the proposed amendments therein contained increase the amount of customer protection and streamline the Act. The amount of protection offered would be increased to an overall limitation of $100,000. However, with respect to claims for cash left in the broker's custody, the limit would remain $20,000. Other amendments would allow a trustee to purchase securities owned by customers which are not on hand and thus will hopefully eliminate a problem prevalent under the Act as initially drafted whereby the customers do not receive their securities but only a cash value determined on the date the broker is placed into receivership or bankruptcy. As to these amendments there is, of course, no complaint with the exception that consideration should be given to increasing the protection afforded respecting cash balances.

Other amendments, however, appear to increase the power of SIPC at the expense of the investor and place upon the investor a very difficult burden of proof respecting claims which are disputed by SIPC. Similarly, while the amendments purport to cover most areas of deficiency in the Act, they do not cover certain areas where a problem is presented respecting investor protection.

During its formative years SIPC representatives have approached the law cautiously and, as a result, there have been numerous instances in which conflicts have arisen between investors who claimed they were entitled to funds under the Act and SIPC which asserted that under its interpretation of the law, the investor was not entitled to the law's protection.

The majority of our comments primarily address themselves to the problem of conflict between the investor, as claimant, and SIPC, as custodian of the trust fund. Other comments go, however, to substantive areas where we believe the Act unfairly restricts the rights of investors or denies them access to an easily available forum.

I

Section 7 of H.R. 8331 proposes to amend Section 5 of the Act by providing that whenever fees and allowances are to be paid by SIPC without reasonable expectation of recoupment and there is no difference between the amount requested and the amount recommended by SIPC, the fees as requested must be ordered by the court. The amendment eliminates the traditional discretion of the court to reduce or modify fees. The amendment also provides that in other cases the court shall place "considerable reliance" on the recommendation of SIPC.

This amendment seeks to reverse the decision of the Second Circuit in _Securities Investors Protection Corp. v. Charisma Securities, Inc._ 506 F2d 1191 (2d Cir. 1974), where the court held that it had discretion to reduce a SIPC recommendation of fees. The _Charisma_ case is instructive. It involved a small liquidation with 37 customers. The trustee sought $5,000 and an additional $25,000 allowance for his firm which acted as counsel. SIPC supported the application and at the circuit court level addressed the court to its special expertise in this area. The district court stated that the case pointed up the probable need for legislative adjustment of the Act and suggested that all appointments of servicing personnel and expenses should be subject to court control. It then proceeded to reduce the fee requested to $10,000. On appeal, the Second Circuit dealt briefly with the argument of SIPC that its recommendation as to fees should be given heavy weight. SIPC analogized itself in a SIPC proceeding to the Commission in a Chapter X proceeding. The court hesitated to draw the analogy, stating that SIPC as of 1974 was not an independent regulatory agency and had not had a long history of knowledgeable and conscientious performance. It concluded by characterizing the SIPC position as amounting to an unwise and dangerous delegation of power which Congress never intended. Section 5(d) of the Act, as amended, would overturn this decision.

If SIPC were a federal agency the amendment could, perhaps, be justified. However, it is a private organization as constituted under Section 3 of the Act [15 U.S.C. 78ccc(a)] and has, during its brief existence, shown itself to be highly concerned with protecting the SIPC trust fund. There is a built-in conflict of interest with the trustee pressing strongly for recognition of customer claims and SIPC, except in the clearest of cases, resisting any claims based upon principles which would expand its liability. The proposed amendment to the Act places the trustee who chooses to advance the interests of the customers over that of SIPC in an untenable position. On the one hand, there is the carrot that if he subscribes to SIPC's position respecting claims, he may obtain a large fee which the court has no jurisdiction to reduce. On the other hand, there is the stick that if he objects to SIPC's position respecting claims, the court must place "considerable reliance" on the recommendation of SIPC when fees are to be determined. In our judgment, this amendment would tend to make the trustees and their counsel in a liquidation under the Act mere agents of SIPC, a result neither contemplated by the Act nor justified by past history.

II

While most sections of the Act have been amended, H.R. 8331 conspicuously does not amend Section 7 of the Act, 15 U.S.C. 78ggg, which is proposed to be designated as Section 11. This section as presently drafted creates a situation where the decision to intervene and pay customers is in practice unilaterally made by SIPC.

Section 7(B) of the Act provides that in the event SIPC refuses to intervene and commit its funds for the protection of customers, the sole remedy is for the Commission

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to apply to the district court where the principal office of SIPC is located for an order compelling SIPC to carry out its responsibilities. The investor does not have a private right of action to compel SIPC to intervene in the affairs of an insolvent broker. See SIPC v. Barbour 95 S.Ct. 1733 (1975).

In practice, this section has created an untenable position for the small investor who decides to make a claim upon the SIPC fund in an instance where SIPC determines not to intervene. The investor, in such instances, does not have easy access to any forum in which a claim may be litigated or ultimately resolved.

By way of an illustration the following situation has been brought to our attention by Los Angeles counsel. The attorneys represent a group of small investors who purchased a tax shelter from a broker. The president of the broker converted the funds and then, as best as can be determined, used the funds in the operation of the brokerage firm. SIPC has apparently taken the position that the broker did not take the funds while acting as agent of the firm.

Whether or not these customers should be covered under the Act is an interesting question. However, the investors are entitled to a forum. Under the present operation of Section 7, the following has transpired:

1. The investors notified SIPC. They received no response, no letter or hearing.

2. The investors notified the Commission. The Commission sent a letter to SIPC. SIPC did not respond to the investors.

3. The investors filed an application before the Commission to compel the staff to sue SIPC to compel SIPC intervention. The application was held pending for several months with no action. It is presently contemplated that the Commission may hold a hearing to gather evidence from which it may determine whether or not to sue to compel SIPC intervention.

4. If the administrative hearing is favorably determined for the investors and the Commission lawsuit is favorably determined to compel SIPC intervention, then a SIPC appointed trustee may be appointed. He may then object to the claims when filed at which point there would be a third trial. Since the average claim is for a modest amount and the Act does not award attorneys fees to a successful claimant, this process does not encourage investors to disagree with SIPC.

The foregoing appears to represent the typical operation of Section 7 when SIPC does not want to intervene. The amendments (which are generally favorable to SIPC) do not contain any provision pursuant to which an investor who feels aggrieved by failure of SIPC to intervene may file an action and get his claim resolved. Remedies which are available against insurance companies, bonding companies, surety companies or the government itself, are precluded by Section 7 of the Act which grants to SIPC, a private organization, an immunity which is somewhat unique.

III

The amendments to the Act would also make it clear that any investor claims are barred unless filed within six months of the date of publication of notice of the proceedings. This amendment carries both practical problems and a strange anomaly.

First, in liquidations conducted by local attorneys, both under the Act and informally, it has been discovered that numerous investors are not sufficiently sophisticated to file a claim within a six-month period. The amendment would clarify the law and cut off the rights of these investors.

Second, it is a peculiar anomaly that the Act as proposed to be amended will allow the trustee the power to conduct the liquidation as if it were a Chapter X proceeding where a six-month claim period is not required but at the same time imposes upon the customer, who is frequently less sophisticated than the ordinary bankruptcy claimant, the stringent time period of an ordinary bankruptcy.

We do not object to some time limitation upon the filing of claims. However, there is a difference between a limitation which may for good cause be extended by the trustee with the approval of the court and a limitation which under all circumstances creates an absolute bar to a customer's claim even when equitable circumstances dictate otherwise.

IV

The proposed amendments to Section 8 of the Act provide that the notice would be sent only to "each person who, from the books and records of the debtor appears to have been a customer of the debtor with an open account within the past twelve months." We do not have any objection to the establishment in the law of a reasonable cut-off period before which notice need not be sent to accounts on the broker's books and records. However, these amendments effectively preclude notice and claims by persons whose transactions were not reflected in the books and records of the debtor but for whose obligations the debtor would ordinarily be responsible. In reviewing these amendments, the subcommittee should take into consideration the fact that, under the present state of the law, a broker may be held responsible for transactions effected through his office or by his representatives whether or not such transactions are reflected on the firm's books and records. See e.g. on the federal level, SEC v. First Securities Co. of Chicago 463 F2d 981 (7th Cir 1972) cert den 409 US 880; on the state level, Black v. Shearson Hammill & Co. 266 CA2d 362, 72 CR 157 (1968) and Blackburn v. Witter 201 CA2d 518, 19 CR 842 (1962).

While we are not certain as to the precise effect intended by the draftsmen of proposed Section 8, it would appear that, inadvertently or otherwise, they are moving to a position whereby a broker would be held liable for all transactions effected by his representatives in the scope of their agency except when the broker came under SIPC protection at which time a legislative restriction on the law as developed in the courts would apply.

V

Section 15 of the amendments amends Section 16 of the Act (15 U.S.C. 78lll) and defines a number of terms including the term "security". Since the Act is an amendment to the 1934 Act, the term "security" presently has the usual broad definition to which we are accustomed. As amended, the definition will exclude investment contracts, certificates of interest or participation in profit sharing plans, or agreements relating to oil and gas programs unless such contracts or programs were the subject of registration statements filed with the Commission. The amendment in practice excludes from SIPC protection the normal tax sheltered offering offered under the private offering exemption. A large number of offerings are not registered with the Commission but are offered instead under an exemption from registration under the 1933 Act. If, as a result of the insolvency of the broker, the investment is not purchased for the customer's account, it would appear irrelevant to the customer whether or not the offering were registered with the Commission or exempt from registration. Both issues go to the quality of information concerning the investment and not to the broker's ability to purchase the investment for his customer's account and to safeguard the customer's funds in the interim between purchase and delivery. The important thing is that the investor receive the protection for his funds which he assumes is available under the Act. It is unlikely that the exclusion proposed by this amendment would be understandable to the average customer or appropriate since most customers assume that SIPC, like the FDIC, covers all losses relating to securities, not specially defined losses.

VI

Section 5 of the Act as proposed to be amended would require the court, if SIPC desires, to appoint SIPC or one of its employees as trustee in any case where the liabilities to unsecured creditors and subordinated lenders are less than $750,000 and there are fewer than 500 customers of the debtor.

If the past experience under the Act is to continue in the future, the typical failure will not be of a large, nationally-known wire house, but of a small, under-capitalized locally-owned and operated firm. Therefore, in most instances, if the proposed amendments are adopted, the trustee will be a SIPC employee. The exact role which the SIPC employee selected as trustee may adopt in reviewing a dispute between a customer and a SIPC policy has not been made clear.

Where a conflict or potential for conflict exists, the SIPC employee cannot act with the independence which the Act demands. His employee relationship and concern over his position will require him to look first to the welfare of SIPC and only secondarily, should the interests collide, to the claim of the customer. Nor can it seriously be argued that the interests of SIPC which pays out funds will always be coextensive with the interests of the customer who desires to receive funds.

In the private practice of law, the canons of ethics focus upon the appearance of impropriety and the potential for conflict as well as the actual impropriety or conflict which would bar a single person from acting both as an employee of the insurer and as a trustee for the insured. In the business world, the use of employees of insurers as trustees for the insured would not be given serious consideration and the role of SIPC in its liquidations is not so unique that these ordinary rules of conduct should be disregarded by an alternative cast into statute without careful and prolonged consideration.

It could be argued that any suggestion that independent trustees should be appointed and SIPC employees not so utilized is a sophisticated means of generating more business for the private bar. This is not the intention. The purpose, rather, is, in the case of a small claim at least, to shift the burden of going forward. If a small claimant should disagree with a SIPC policy, the economics of his claim will perforce require him to accept the SIPC policy if the trustee is a SIPC employee. The average claim is often for considerably under $3,000 and the average customer is frequently unsophisticated. Under such circumstances, the customer's ability to obtain an attorney to advance his own interests is limited. If, alternatively, an independent trustee is appointed and the trustee agrees with the customer, the trustee may press the claim and SIPC must determine whether to object. The burden of objecting should be placed more heavily upon the insurance agency than upon the claimant and our reluctance to endorse the proposition that SIPC employees should act as trustees is based on the adverse effect upon the burden of going forward which this amendment would cause.

Decisions which curtail the appointment of an independent trustee and reduce court supervision may initially appear palatable on the grounds that they may substantially reduce the administrative expenses connected with a liquidation. The proposed amendment allowing use of SIPC employees as trustees may not, however, result in a large cash saving. At best, it may simply disguise costs by incorporating them into the payroll section of the SIPC budget. Trustee's fees and the fees of their attorneys under both the Act and ordinary bankruptcy procedures closely relate to an hourly rate which is reviewed by the court and determined to be equal to or lower than the prevailing rate in the community. A substantial fee can only be incurred if a large number of hours is expended.

The time records attached by most trustees to their fee requests generally indicate, as a partial explanation for the high costs, a statutory scheme which the proposed amendments do not change.

VII

The amendments add a Section 10 which provides that if the claims of all customers of the broker aggregate less than $250,000 and other conditions exist, SIPC may pay the claims by a direct payment procedure and without formal court proceedings. Subsection (E) provides that in such a proceeding if an investor is not satisfied with a SIPC determination respecting his claim, he may file an action in the district court where the head office of the debtor is located.

The direct payment procedure is hardly objectionable. However, the provision for resolution of disputed claims creates an impossible burden for the ordinary investor. First, federal court litigation is time consuming and expensive and can be borne easily by SIPC but not by the investor. There is no reason why such litigation could not be resolved by the informal procedures of the bankruptcy court and not the district court.

Second, the subsection, by providing that lawsuits must be brought in the district where the head office of the debtor is located, effectively supersedes the liberal and investor oriented venue requirements of the federal courts. In reviewing this matter, some members of our committee were concerned over the venue provisions which presently exist in the SIPA. One or two who had, in the past, prosecuted claims for investors in out of state liquidations were of the opinion that the present SIPA venue requirements, which require that the action be brought at the head office of the debtor, place an intolerable burden upon an investor with a modest claim. This feeling translated over a fortiori to the proposed

direct payment procedure. If this procedure is adopted, the small-town investor who feels himself aggrieved by a decision of SIPC respecting his claim will find himself compelled, in certain instances, to fly to New York or some other large metropolitan center in order to present a claim arising out of a branch office transaction for an amount which may not exceed $3,000 to $5,000.

Interestingly, the proposed amendments would allow litigation against the broker in a SIPC liquidation only at its head office at a time when the Supreme Court, in a recent decision, has reversed the old rule respecting banks and held that they may be sued in the district where they maintain branch offices. We feel that if banks can absorb the costs of such branch office litigation, a brokerage firm under SIPC jurisdiction may also assume such a cost.

VIII

As you may be aware, there have been problems with the present format of SIPA whereby securities owned by the customers were sold by the trustees over the objection of the customer and despite the customer's willingness to pay indebtedness owing on the securities. Section 8 of the Act as amended provides that the trustee must deliver customer name securities to the debtor if the customer is not indebted to the broker or if he is willing to pay his indebtedness. However, the term "customer name securities" is defined in amended Section 16 of the Act to exclude securities which by endorsement or otherwise are in negotiable form and, therefore, as we read this amendment, it would ordinarily not apply to securities in a margin account.

IX

The amendments also provide that if a self-regulatory agency assists in a self-liquidation under the Act, it shall be immune from any actions resulting from its activities thereby. This grants self-regulatory exchanges and agencies an immunity which is nowhere else found in the 1934 Act.

X

One of our committee members is concerned that while the Act requires assessments of brokers, they are not entitled to its protection when a fellow broker becomes insolvent. In this connection, he notes that, as so interpreted, the Act does not prevent the "domino" effect of one broker's failure upon another. This point was illustrated in the recent bankruptcy of the Los Angeles brokerage firm of T. P. Richardson & Co., Inc. Many of the claims against this broker were from other brokers, and when SIPC declined to intervene, the capital of the other brokers was severely impaired.

As we have previously noted, those provisions of the bill which would increase the limitations on the dollar amount of protection afforded the customer and which would streamline the administration of SIPA without limiting the rights of customers are unobjectionable and, if feasible, should be given prompt consideration. However, we feel that the other amendments should receive further study. In this connection, it appears to us that the Commission, in its statutory mandate of oversight over SIPC, should take a vigorous and active role in this area and consider and evaluate the legislation and, in particular, take into consideration the several years of practical experience under the present law. The SIPC arrangement is an unusual one and difficulties which have arisen in its operation in, among other things, the areas of conflict of interests and other matters discussed in this letter should not be inadvertently exacerbated.

XI

If the thrust of the present amendments is the reduction of cost, there are means of achieving this goal which do not do violence to the concept of customer protection.

One possibility would be to allow trustees to select their own supporting personnel with the concurrence of the court, without obtaining prior approval of SIPC. The right given SIPC to pass on support personnel often results, in practice, in SIPC running liquidations via long distance with a consequent increase in administrative costs.

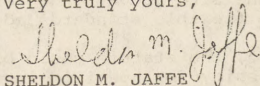
Second, the function of a trustee could be limited to the payment of customer claims. Thereafter, the debtor could be referred to the bankruptcy court for a traditional liquidation in a bankruptcy proceeding guided by bankruptcy experts. The cost of this proceeding would not be reflected in the SIPC budget and presumably would be governed by the more flexible standards adopted by the federal courts.

Third, the statute could be redesigned to eliminate the necessity for specific intervention by SIPC with all the complexities that this might entail. The statute could perhaps allow a trustee in or outside of bankruptcy to directly request from SIPC, funds for the payment of customers.

One of the members of our subcommittee feels strongly that payment of customer claims under the SIPA should be removed entirely from the Bankruptcy Act. He argues - and with considerable force - that the bankruptcy courts are traditionally reluctant to grant a party a favored creditor status and, therefore, under Section 60(e), numerous decisions cast the customer in the position of a general creditor. Under the SIPA, he notes, this tradition has been continued and the result has often been detrimental to the customer's position under the Act.

None of the foregoing suggestions, however, are cast in concrete. Rather, we in concert believe that their very diversity indicates that the time has come now, seven years after passage of the SIPA, for a thorough study to be made of the SIPA by an independent group seeking input from the various bar associations, the Securities and Exchange Commission, the attorneys who have practiced in this area and some of the investors who may have had experience with the Act. Such a study might adopt one or more of the foregoing suggestions. At a minimum, such a study would hopefully suggest changes in the proposed amendments which would eliminate the conflict of interest problems raised by this letter. Alternatively, it might determine that an entirely different approach to the problem of broker-dealer liquidations should be explored. In any event, we hope that these comments may serve as a basis from which a more thorough analysis of the proposed amendments may be made.

Very truly yours,



SHELDON M. JAFFE

On Behalf of the Executive
Committee of the Business and
Corporations Law Section of the
Los Angeles County Bar Association

SMJ:tb

cc: Ann Holland, Esq.
Kindel & Anderson

Joseph Troy, Esq.
William J. Feis, Esq.
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Marvin Greene, Esq.
Loeb & Loeb

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A PROFESSIONAL CORPORATION

January 9, 1978.

Howard Menell, Esq.
Assistant Counsel
United States Senate
Committee on Banking, Housing &
Urban Affairs
Washington, D.C. 20510

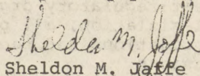
Re: Comments to H.R. 8331, 1977 Amendments to Securities Investor Protection Act of 1970

Dear Mr. Menell:

Thank you very much for your letter of January 4, 1978 concerning the comments of the Business and Corporations Law Section of the Los Angeles County Bar Association.

Please also excuse this brief and somewhat technical note. The party submitting the comments was the Business and Corporations Law Section of the Los Angeles County Bar Association, not the Los Angeles County Bar Association per se. Comments by the Bar Association per se may be made only by the trustees. Comments by our section, which is a subsection of the Los Angeles County Bar Association, are made under the authorization of our executive committee. Also of note, I have now been advised that the membership of our section may exceed 1,000 members.

Very truly yours,



Sheldon M. Jaffe

SMJ/mc

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SUBCOMMITTEE ON CONSUMER PROTECTION AND FINANCE
OF THE
COMMITTEE ON INTERSTATE AND FOREIGN COMMERCE
WASHINGTON, D.C. 20515

January 18, 1978

Howard A. Menell, Esq.
Counsel
Subcommittee on Securities
Committee on Banking, Housing,
and Urban Affairs
United States Senate
Washington, D.C. 20510

Dear Howard:

Thank you for your letter of January 5, 1978, concerning H.R. 8331 and enclosing a letter of Sheldon M. Jaffe on behalf of the Business and Corporations Law Section of the Los Angeles County Bar Association. At your request, I am happy to share my reaction to Mr. Jaffe's comments.

I suppose the portion of Mr. Jaffe's letter which concerns me the most is the suggested "lack of attention" addressed to the proposed Amendments by the SEC, the Bar, and others who have experience under the Securities Investor Protection Act of 1970. As I know you are well aware, the process of the consideration of H.R. 8331 was neither summarily nor callously conducted. Quite frankly, I'm hard put to understand the basis for that contention. As you know, the genesis for the Amendments was a report dated July 31, 1974, of the SIPC Special Task Force whose members included representatives of SIPC, the Commission, the private bar, the securities industry, and the self-regulatory organizations. During the development of the legislation, all persons who acted as trustees in SIPC liquidations had been canvassed for comments on two separate occasions.

In the 94th Congress, the Subcommittee held three days of hearings on October 20-22, 1975, at which time twenty-two witnesses appeared representing SIPC, the SEC, the securities industry and investors. In addition, supplemental material was received for the record, including a letter of August 26, 1975, from Mr. Jaffe on his own behalf which is substantially the same as his present communication on behalf of the

Los Angeles County Bar Association. Since Mr. Jaffe's letter was the most broadly critical submission we received at that time (or since) we carefully reviewed each of his suggestions in connection with preparing H.R. 8331 for introduction. In particular, we considered the nature of the possible conflicts, emphasized by both of Mr. Jaffe's letters, in smaller liquidations with a SIPC employee as trustee. We concluded that any possible conflicts of interest would be minimal, and that, in any event, the court was present to resolve any dispute. Of course, the overriding factor in appointing the SIPC employee is the preservation of the assets of an estate. I think Mr. Jaffe is aware of these costs. As a matter of fact, he was the trustee in one of the many cases reviewed in making this determination. In that case the trustee's fee was $32,500, although the assets in the debtor's estate available to pay the fee were only $6,241. I hasten to add that Mr. Jaffe's fee was fully justified. However, this example, which is but one of many, underlines the kinds of costs to the estate which would be avoided by H.R. 8331.

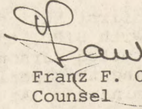
Throughout 1976 and the first half of 1977, the Subcommittee staff met continuously with SIPC, the SEC and members of the industry and other interested persons in an effort to improve the original bill. During this period, a number of drafts were prepared and disseminated. At the same time, nearly identical legislation was being reviewed and approved by both the American Law Institute Securities Code Project under Professor Loss and, subsequently by the American Bar Association. On August 1, 2, and 3, 1977, the Subcommittee held hearings on H.R. 8331. A number of substantive amendments were adopted by the Subcommittee during markup on September 7, 1977. Given the widespread publicity which the bill received at each stage from its introduction to its passage by the House on November 1, 1977, by the trade journals which anyone with more than a passing professional interest in such matters would normally receive, I have difficulty understanding how those members of the Los Angeles County Bar could have been unaware of the bill's progress. As a matter of fact, as is clear from Mr. Jaffe's letter, the Association was working with H.R. 8331 as introduced and not as reported from Subcommittee on September 7, 1977, nor as passed by the House.

Finally, I would like to clarify the record in two areas. First, the Commission and its staff worked long hours, including nights and weekends to meet our timetables for comments on the various drafts of the bill and on the bill itself. This effort was under the supervision of Commission Senior Counsel Robert Millstone and I suggest with respect to any questions

Mr. Jaffe may have as to the Commission participation, that he contact Mr. Millstone or Commissioner Philip A. Loomis, Jr., who twice testified on the Amendments. Second, on page five of his letter, Mr. Jaffe, in illustrating his concern about the lack of private rights of action to compel SIPC to intervene in the affairs of an insolvent broker-dealer, refers in some detail to a situation "brought to our attention by Los Angeles counsel". The record reflects that the case referred to, which is presently pending before the SEC, is Benchmark Securities and that Mr. Jaffe is one of the attorneys for the applicants.

I appreciate the opportunity to comment on the Los Angeles County Bar letter. It goes without saying, Howard, that I and the rest of the Subcommittee staff will be happy to provide any further assistance that may be required on this important legislation.

Sincerely,



Franz F. Opper
Counsel

cc: Sheldon M. Jaffe, Esq.
Ann Holland, Esq.
Joseph Troy, Esq.
Marvin Greene, Esq.
Gavin Miller, Esq.
William Gould, Esq.
Robert Millstone, Esq., SEC
Theodore Focht, Esq., SIPC
William Feis, Esq.

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January 19, 1978

Howard A. Menell, Esquire
Assistant Counsel
Committee on Banking, Housing
and Urban Affairs
United States Senate
Washington, D.C. 20510

Dear Howard:

Many thanks for sending me a copy of the letter addressed to you by Sheldon M. Jaffe, dated December 20, 1977, dealing with H.R. 8331, and requesting any reactions I may have to it. The letter, which purports to express the views of the Executive Committee of the Business and Corporations Law Section of the Los Angeles County Bar Association, presents little that is new in the now extensive consideration which has taken place with respect to the SIPC proposals since they were first developed in 1974. Indeed, in August 1975, Mr. Jaffe (then identifying himself as a "member of the Executive Committee of the Los Angeles County Business Corporation Law Section" but specifically stating that the thoughts presented were his personal views and not the views of any other persons) sent basically the same comments to Congressman Lionel Van Deerlin, then Chairman of the House subcommittee which was considering the SIPC amendments. See pages 204-211 of House Hearings on H.R. 8064, October 21-22, 1975, Serial No. 94-56.

It is my understanding, based on information received from responsible and reliable sources in Los Angeles, that the present letter not only does not speak for the Los Angeles County Bar Association nor for its Business and Corporations Law Section, but also does not necessarily speak for the entire Executive Committee of that Section. Rather, a more accurate characterization would be that the letter speaks for some attorneys who are also members of the Executive Committee of the Business and Corporations Law Section of the Los Angeles County Bar.

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There are numerous errors in the letter. An example is the statement on page 2 to the effect that the amendments will limit the SIPC advance for cash left in a broker's custody to $20,000. The limit is $40,000, as you will note from page 44, lines 3-8 of H.R. 8331.

What is far more troublesome is the letter's failure to represent accurately the consideration and review which has taken place with respect to these proposals over the past four years. The letter (1) complains about the "lack of attention addressed to the proposed amendments," (2) states that SIPC operations "have been monitored neither by the bankruptcy bar nor the corporate bar," and (3) concludes that the SEC "should take a vigorous and active role in this area and consider and evaluate the legislation."

The letter is in error with respect to each of the above matters. The proposals which are presently being considered by Congress are the result of a seven-month study by a task force appointed by Chairman Owens in December 1973. The task force report, when issued in July 1974, was widely disseminated and comments on it were sought. The amendments currently in H.R. 8331 are basically the same as proposals which were contained in bills in both the Senate and House in 1974, 1975 and 1977. Hearings have been held by the House of Representatives in October 1975 and August 1977.

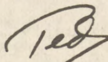
In addition, the proposals contained in H.R. 8331 have been thoroughly reviewed by the Council as well as the full membership of the American Law Institute. Prior to that review the proposals had been carefully analyzed by Professor Louis Loss and the consultants and advisors to the project which Professor Loss heads for the codification of the federal securities laws. In the course of that consideration, the proposals were also reviewed by the Committee on Federal Regulation of Securities of the Section of Corporation, Banking and Business Law of the American Bar Association. Those groups included in their membership some of the leading members of the Bankruptcy Bar and the Corporate Bar.

Finally, the SEC has always taken a very significant role in the development, consideration and review of these proposals. Members of the Commission and its staff participated in the deliberations of the task force in 1974 and played an active role in the development of the legislative proposals. As even a casual review of the hearing records in the House of Representatives will show, the Commission has evaluated the proposals and supports them. Mr. Jaffe's implication to the contrary (at page 13) is unjustified.

Frankly, Howard, I could continue an analysis of the comments made in Mr. Jaffe's letter, but I think it would not be useful at this point. The views expressed in the letter are hardly new. They have been considered and evaluated in the course of the extensive consideration which has been given to these amendments. Should you or any members of the Senate desire our specific views on any of the particular suggestions made by Mr. Jaffe, we shall, of course, be pleased to respond.

Again let me thank you for your courtesy in calling Mr. Jaffe's letter to my attention.

Very truly yours,



Theodore H. Focht
General Counsel

cc: Robert J. Millstone, Esquire
Securities and Exchange Commission

Franz F. Opper, Esquire
U.S. House of Representatives

Business & Corporations Law Section
of the
Los Angeles County Bar Association

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March 8, 1978

Howard Menell, Esq.
Assistant Counsel
Committee on Banking, Housing
and Urban Affairs
United States Senate
Washington, D.C. 20510

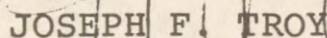
Re: Comments to H.R. 8331; Amendments to
Securities Investor Protection Act of 1970

Dear Mr. Menell:

As Chairman of the Executive Committee of the Business and Corporation Law Section of the Los Angeles County Bar Association, I am writing this letter to correct a misimpression set forth in the response of the Securities Investor Protection Corporation ("SIPC") to our letter dated December 20, 1977, concerning H.R. 8331.

Paragraph 2 of the SIPC response implies that our December 20, 1977, letter did not speak for the Executive Committee of our Section as a whole. This is incorrect. The letter not only expressed the views of the subcommittee but was also discussed by our committee as a whole and represents its authorized statement. I would, therefore, like to express the request of our committee that our comments be considered upon their substantive merit.

Very truly yours,



JOSEPH F. TROY

bg
cc: Ann Holland
Marvin Greene
William Gould
Sheldon Jaffe
Gavin Miller

DIVISION OF
MARKET REGULATION

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

January 27, 1978

Mr. Howard A. Menell, Counsel
Subcommittee on Securities
Committee on Banking, Housing
and Urban Affairs
5300 Dirksen Senate Office Building
Washington, D. C. 20510

Dear Howard:

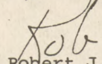
Thank you for bringing to my attention the letter to you from Sheldon M. Jaffe, writing on behalf of the Executive Committee of the Business and Corporations Law Section of the Los Angeles County Bar Association. Mr. Jaffe made various comments concerning H.R. 8331, a bill to amend the Securities Investor Protection Act of 1970, which passed the House of Representatives on November 1, 1977, and was subsequently referred to your Subcommittee.

I note, in particular, that Mr. Jaffe stated concern over "the lack of attention addressed to the proposed amendments." He suggested, in that regard, that the Commission should take "a vigorous and active role" in considering and evaluating the legislation. As you are aware, the Commission has been involved in preparing these amendments from the earliest legislative proposals to the bill as passed by the House. We presented extensive written comments to the House Subcommittee on Consumer Protection and Finance, and Commissioner Loomis testified before that Subcommittee on two occasions. We, of course, look forward to assisting the Senate Subcommittee in its consideration of the bill, as well.

I have had the opportunity to review the letters to you from Franz Opper and Ted Focht concerning Mr. Jaffe's letter. I believe Franz and Ted expressed clearly the care which went into preparation of H.R. 8331, and, in general, I agree with their observations.

I appreciate being apprised of Mr. Jaffe's letter.

Sincerely,



Robert J. Millstone
Senior Special Counsel

BRADFORD
NATIONAL CORPORATION
1700 BROADWAY · NEW YORK, N. Y. 10019 · (212) 581-5800

October 7, 1977

The Honorable Harrison Williams
Subcommittee on Securities
Committee on Banking, Housing and Urban Affairs
United States Senate
Washington, D.C.

RE: H.R.8331: Securities Investor Protection Act Amendments of 1977

Dear Mr. Williams:

This letter is to comment on several provisions of H.R.8331, the Securities Investor Protection Act Amendments of 1977 which the Committee on Interstate and Foregin Commerce has reported out favorably. I understand that this legislation will be voted on by the House of Representatives in the very near future.

Bradford National Corporation (BNC) is very interested in and will be affected by this legislation. Bradford Securities Processing Services, Inc. (BSPS), a wholly owned subsidiary of BNC, is registered with the Securities and Exchange Commission (SEC) as a clearing agency. BSPS provides comparison, clearance and settlement for transactions in securities, particularly municipal and other exempt securities under the Securities Exchange Act of 1934. Although the manner in which BSPS performs these services is not as sophisticated as that of other clearing agencies, BSPS has undertaken to develop a comparison and a continuous net settlement system similar to those of other clearing agencies and to offer such services by 1978. Another subsidiary of BNC, Bradford National Clearing Corporation has facilities management contracts to operate the NCC division of the National Securities Clearing Corporation, the Pacific Clearing Corporation and the Pacific Securities Depository Trust Company, all of which are registered clearing agencies. A third subsidiary of BNC, Bradford Trust Company, owns 20% of the stock of TAD Depository Corporation (TAD). TAD is registered with the SEC as a clearing agency offering the activities of a securities depository. Although the range of depository services currently offered by TAD are not as extensive as those offered by other securities depositories, TAD has undertaken a program to develop

and begin offering such services by 1978. A fourth BNC subsidiary, Bradford Securities Operations, Inc. has a facilities management contract to operate TAD.

H.R. 8331 attempts to amend the Securities Investor Protection Act of 1970 to overcome certain shortcomings that have arisen in the operation of the legislation. However, as proposed, H.R.8331 will adversely affect the ability of BSPS to compete with clearing agencies currently offering comparison and continuous net settlement systems at such time as BSPS has developed its own comparable system and will adversely affect the ability of TAD to compete with securities depositories offering a full range of depository services when TAD finishes its expansion program. BSPS and TAD are expanding and have spent substantial sums to develop these new programs and to prepare an intensive marketing campaign to attract clients for these services. As proposed, H.R.8331 will place BSPS and TAD in a materially disadvantageous competitive position in offering these services even though, as presently planned, BSPS and TAD will charge less for these services than their competitors.

All the other clearing agencies which offer comparison and continuous net settlement services and with which BSPS is about to compete more vigorously, require their participants to deposit cash or to plege municipal or federally issued or guaranteed securities as collateral for a note to the clearing fund of that clearing agency. Similarly, the securities depositories with which TAD is about to compete more vigorously require contributions to their clearing funds. These clearing funds indemnify the participants in that clearing agency against losses that they may suffer in closing out contractual commitments of a participant. In the event of the insolvency of a clearing agency participant in a continuous net settlement system, the agency will allocate to the other participants the contra-side of the obligations that the insolvent participant owed to the clearing agency. To the extent that these other participants may suffer losses in liquidating these open positions of the insolvent participant, the clearing fund of that agency indemnifies these participants. Each participant's deposit to the clearing fund and the clearing fund, in the aggregate, must be substantial.

The Securities Acts Amendments of 1975 in adding Sections 17A(b)(1), 17A(b)(3)(A) and 17A(b)(5)(C) to the Securities Exchange Act clearly reposed in the SEC and the clearing agencies

authority to establish standards for the financial responsibility of clearing agency participants and the consummation of their trade obligations. Pursuant to that authority the SEC, in Release 34-13584 (June 1, 1977), discussed various standards that could be made applicable to clearing agencies. Among these were the financial obligations of a clearing agency to its participants in the event of the insolvency of one participant and the standards that should be imposed on participants as well as clearing agencies to meet the risk of insolvency of a participant. As presently proposed, new Section 8(e) to the Securities Investor Protection Act (SIPA) would eliminate the flexibility granted the SEC to adopt standards in this area.

New Section 8(e) of SIPA, as proposed, would have several adverse effects. To indemnify its participants against losses from closing out open obligations of an insolvent participant, a clearing agency would either have to assume the risk of the insolvency itself, or it would be compelled to require substantial deposits in a clearing fund by all of its participants. If the clearing agency were to assume the risk of loss, it would require a substantial capitalization far in excess of that of almost all existing clearing agencies. Such a substantial capitalization would compel the clearing agency to set its fee structure at a high level so that it could generate sufficient net revenues to offer return sufficient to attract such a substantial amount of capital.

In the alternative new Section 8(e) of SIPA would force clearing agencies to compel participants to make substantial clearing fund deposits. The clearing fund deposit represents working capital of a broker/dealer which is no longer available to it. The SEC recognizes this and allows including clearing fund deposits as part of a broker/dealer's net capital. As capital is a finite item and a limited quantity, a broker/dealer cannot afford to tie up substantial sums of capital in clearing fund deposits which are not available to it for use in the course of its daily operations.

Broker/dealers required to make substantial clearing fund deposits will only be able to do so if they are very substantially capitalized. The major brokerage firms are able to utilize the services of more than one clearing agency. Many medium-sized brokerage firms can only afford the capital expenditure required to make a clearing fund deposit in one clearing

agency. Lesser capitalized brokerage firms are forced to utilize a correspondent in accessing the services and facilities of existing and to-be-developed clearing agencies. Quite clearly, clearing fund deposits limit access to clearing agencies. Further, as Section 8(e) is proposed, a clearing agency can be protected by requiring a clearing fund deposit, and the larger such deposit the more it is protected. At the same time this defeats the utility of a clearing agency by limiting access to it.

H.R.8331 loses sight of the fact that clearing agencies are service entities. Their function is to reduce the delivery obligation of the participating brokers and dealers so that the net movement of securities and the net movement of funds of these participants resulting from their respective securities transactions is less than it would be if each trade had to be settled on the basis of a movement of securities and a counter-movement of funds for each specific trade. If the clearing agencies did not perform these services then all these open contractual commitments of an insolvent broker/dealer which would otherwise be eliminated by a continuous net settlement or daily balance order system would come within the provisions of Section 6(d) of SIPA resulting in probably an even greater number of claims on SIPC as well as materially increasing the cost of liquidating an insolvent broker/dealer.

If prospective participants are required to make substantial clearing fund deposits to BSPS and TAD in order to utilize the new services that are being developed, they will be put in a difficult position. These prospective participants will either be forced to have deposits with more than one clearing agency in order to utilize the different services of the various clearing agencies, or they will be forced to choose between two entities offering similar services, the less costly of which is less experienced than the other. The result of all this would be that only a few of the major brokerage firms would be sufficiently capitalized that they could utilize the services of both BSPS, TAD and the existing clearing corporations. Medium-size and other brokerage firms would be very reluctant to cast their lot with BSPS or TAD, which would be offering these services at less cost to the broker but without the experience that the existing clearing agencies have. Lesser sized brokerage firms would not be able to participate at all in either BSPS, TAD or any of the other existing clearing agencies offering these services.

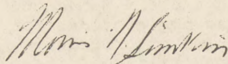
In light of the above, we recommend that Section 8(e) of SIPA, as proposed in H.R.8331, be amended to treat the claims of a clearing agency occasioned by closing out open commitments of an insolvent broker/dealer participant as within Section 6(d) of SIPA as a claim on account of a customer transaction if the clearing agency provides for closing out such commitments and has adopted rules or procedures, approved by the SEC, for the financial responsibility of its participants and to assure that its participants meet their deliver and receive obligations.

Another area of concern is the failure of H.R.8331 to recognize certain existing practices in the brokerage industry. Clearing agencies, such as BSPS and the National Securities Clearing Corporation which offer physical delivery services in New York City, and the participating broker/ dealers, have the custom and practice of delivering securities and then returning some two hours later to obtain the broker's check in payment. If during this period of time, the broker/dealer should be declared insolvent and subsequently brought within the auspices of SIPC, the clearing agency could be in the position of an unsecured general creditor. The SIPC trustee would have the securities delivered to it, and the clearing agency would only have a claim. If the broker/dealer should pay the clearing agency with an uncertified check and the broker should be declared insolvent and brought within the auspices of SIPC before the check has cleared, the clearing agency again could be in the position of an unsecured general creditor. One answer is to require the cross delivery of securities against receipt of certified checks. This is not operationally efficient in the physical delivery of securities, particularly in the New York metropolitan area. Further, requiring certified checks in payment of deliveries in these instances would only increase the time necessary to process the transaction and the costs of the broker/dealers--e.g. additional clerical and messenger staff to obtain certification plus the fees charged by the banks for certifying checks. In light of this, we strongly recommend amending the definition of customer so that clearing agencies who have made deliveries to a broker/ dealer which prior to the payment therefor (clearing of the check) comes within the auspices of SIPC are deemed to be customers.

Should H.R. 8331 or similar legislation be presented to the Subcommittee on Securities we would appreciate your including

this letter in the Subcommittee's hearings and would welcome the opportunity further to expand on our comments.

Sincerely yours,



Morris N. Simkin
Counsel

cc: Howard Minnell, Esq.
Subcommittee on Securities,
Committee on Banking, Housing and Urban Affairs

Securities and Exchange Commission
attn: Robert Millstone, Esq.

Securities Investor Protection Corporation
attn: Theodore Focht, Esq.

MNS/tc

Investment Company Institute
1775 K STREET N. W., WASHINGTON, D. C. 20006
(202) 293-7700

MATTHEW P. FINK
GENERAL COUNSEL

April 24, 1978

Honorable Harrison A. Williams
Committee on Banking, Housing and Urban Affairs
United States Senate
Washington, D.C. 20510

Dear Senator Williams:

Thank you for your letter of April 17, 1978 inviting our comments concerning H. R. 8331, the Securities Investor Act Amendments of 1977.

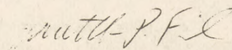
We support the enactment of the bill in the form passed by the House of Representatives last year. We believe that the bill would substantially improve the Securities Investor Protection Act of 1970, while retaining appropriate exemptions for mutual funds and variable annuities which Congress originally enacted in 1970. As you will recall these exemptions were included in the original legislation because neither mutual funds nor variable annuities presented investors with the kinds of hazards which necessitated the insurance coverage provided by the Act.

As you know, the original bill as introduced in the House would have deleted mutual fund and variable annuity exemptions. We and others testified before the Subcommittee on Consumer Protection and Finance of the House Interstate and Foreign Commerce Committee in opposition to these proposed changes and presented data showing that the factual pictures on which the exceptions had been based still held true. Enclosed is a copy of our written statement which we would respectfully request be included in the record. In September of last year the House Subcommittee and full Committee unanimously approved the bill which was revised so as to include the original mutual fund and variable annuity exemptions. The House Committee Report stated:

"The Committee determined to continue to exclude from SIPC membership all persons whose business consists exclusively of (1) the distribution of shares of registered open and investment companies or unit investment trusts, (2) the sale of variable annuities, (3) the business of insurance, or (4) the business of rendering investment advice to investment companies or insurance company separate accounts. As originally written, the bill sought to repeal this exemption from SIPC membership. However, after extensive deliberation the Committee concluded that the exemptions should be retained since SIPC's experience since 1970 has shown that the distribution system for mutual fund shares and variable annuities continues not to create the kinds of risk created by general brokerage activities." (H.R. Rpt. No. 95-746, 95th Cong., 1st Sess., 1977 at 23-24).

In summary, we urge your Committee to report out the bill retaining these exemptions. We greatly appreciate this opportunity to submit our written comments concerning H. R. 8331.

Sincerely,



Matthew P. Fink

Enclosure
cc: Howard Menell

August 2, 1977

Before the Subcommittee on Consumer Protection
and Finance, House Interstate and Foreign
Commerce Committee

STATEMENT OF DAVID SILVER, PRESIDENT OF THE
INVESTMENT COMPANY INSTITUTE, WITH RESPECT TO
H. R. 8331

My name is David Silver. I am testifying today on behalf of the Investment Company Institute, of which I am President. With me is the Institute's General Counsel, Matthew Fink.

The Institute is the national association of the mutual fund industry. Its members consist of 415 open-end investment companies (commonly called "mutual funds"), their investment advisers and principal underwriters. Our mutual fund members have about 7 1/2 million shareholders and assets of approximately $47 billion, comprising over 90% of the assets of all U. S. mutual funds.

We appear in opposition to so much of Sections 2(a), 6(b)(4) 6(g) and 15 of H. R. 8331 as would change the Securities Investor Protection Act (the "Act") by repealing certain existing exemptions for mutual funds and variable annuities and subject non-broker-dealer affiliates of SIPC members to SIPC assessments.*

* More particularly, these sections would: (1) impose mandatory membership in the Securities Investor Protection Corp. (SIPC) on broker-dealers whose business consists exclusively of the distribution of mutual funds, unit investment trusts or variable annuities, or rendering investment advisory services to mutual funds or insurance company separate accounts; (2) require the inclusion in the SIPC assessment base of broker-dealers doing a general retail securities business of the revenues which they derive from the sale of mutual fund shares; and (3) include gross revenues of investment advisers who are not broker-dealers in the SIPC assessment base if a related company is a broker-dealer.

I am certain that the Chairman of this Subcommittee, who actively participated in the formulation of the SIPC legislation, remembers well the grim background of crisis and impending chaos in the nation's securities markets in 1970. It was in that atmosphere that SIPC was created as being the least disruptive alternative to the outright termination of the specific practices traditionally engaged in by stock exchange members which created the potential for huge losses to investors. However, those who would repeal the mutual fund and variable annuity exemptions have deftly shaded the legislative history and background to make it appear that the mutual fund and variable annuity exemptions are anomalies in an insurance scheme which was designed to be universal. But SIPC was not created to cast an umbrella of insurance protection over the entire securities industry -- any such assertion is merely an after-the-fact rationalization to justify an expansion of the jurisdiction of SIPC. More importantly, the mutual fund and variable annuity exemptions were included in the law because they were justified by the circumstances and, as I will show later, demanded by equity.

SIPC WAS CREATED TO PROTECT INVESTORS AGAINST RISKS ASSOCIATED WITH PRACTICES OF BROKERAGE FIRMS DEALING WITH CUSTOMERS' FUNDS AND SECURITIES FOR THEIR OWN BENEFIT

When SIPC was created in 1970, it was clearly understood that the risks to be insured against were the results of specific business practices of the brokerage industry. More particularly, these risks are created by the traditional practice of firms doing a general stock brokerage business using customers' funds (free credit balances) and customers' securities in the conduct of their own business. The 1970 reports of the Senate Committee and of this Committee isolated

and focused on these activities as creating the hazards to the investing public which necessitated the creation of SIPC.*

The wave of brokerage house insolvencies which immediately preceded the creation of SIPC at the end of 1970 involved the potential of enormous losses for the millions of investors whose cash and securities were held and used by brokerage firms. The situation had become so grave that stock exchange trust funds which had been formed to take care of obligations owed customers of failed firms were near exhaustion. It was at this juncture that the Congress was implored by the industry itself to enact the legislation which evolved into the Act.**

At the 1970 legislative hearings, it was the position of the mutual fund and insurance industries that the distribution of mutual fund shares and variable annuities, as well as the rendering of investment advice to registered investment companies, did not present

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* The Senate report stated: "Free credit balances are funds left with the brokerage firm by customers who have the right to withdraw them on demand. These credit balances are used by the broker...in the conduct of the business..." (Report No. 91-1218, Senate Committee on Banking and Currency, 91st Cong. 2d Sess. (1970)). The report of this Committee commences its discussion by stating: "Broker-dealers, among their many obligations, are responsible for safeguarding billions of dollars in cash and securities which belong to investors." (Report No. 91-1613, House Committee on Interstate and Foreign Commerce, 91st. Cong. 2d Sess. (1970)).

**<u>Study of Unsafe and Unsound Practices of Brokers and Dealers</u>, SEC, Vol. 2, Chapter IX, pages 15-16.

any significant potential for the kind of losses inherent in the traditional activities of stock brokers who deal for their own benefit with the funds and securities of their customers. Moreover, since mutual fund and variable annuity organizations did not engage in such activities, they obviously did not profit from them. It was on this basis that Congress saw fit to include the mutual fund and variable annuity exemptions in the legislation.

The matter of SIPC jurisdiction over investment advisers who are affiliates of broker-dealers was not an issue in 1970. In a sense this proposed change illustrates best that the proponents of these amendments seek to extend the jurisdiction of SIPC far beyond the boundaries of the brokerage industry and the conditions which gave rise to the need for its creation. Investment advisers perform no function and earn no fee even remotely related to the risks covered by SIPC. We will return to this proposal after we discuss the mutual fund and variable annuity exemptions.

THE MUTUAL FUND DISTRIBUTION SYSTEM DOES NOT CREATE THE KIND OF RISK CREATED BY GENERAL BROKERAGE ACTIVITIES

Before engaging in a description of the specific factors which in the present context differentiate the purchases and sales of mutual fund shares from purchases and sales of other securities by customers of brokerage firms, it should be noted that the Act (Section 11(h)) mandated the SEC to conduct a study of unsafe and unsound practices of broker-dealers. The report specifically confirmed the factual basis underlying the exemptions for mutual funds and variable annuities. The report stated: "Also, broker-

dealers who specialize in the sale of mutual fund shares or variable annuities do not hold customers' free credit balances in the normal course of business."* Anticipating our discussion of this subject, it might be observed that this conclusion inevitably flows from the ordinary practices in the distribution of mutual fund shares.

The Mutual Fund Underwriter

Unlike broker-dealers doing a general securities business, a mutual fund underwriter does not use customers' funds or securities in the course of its business.** When a customer purchases mutual fund shares, it is the fund's transfer agent which issues the shares to the customer against receipt of the purchase money and sends the money to the fund's custodian bank which often is the same entity as the transfer agent. When a customer redeems mutual fund shares, it is the fund's transfer agent which issues the redemption check against receipt of the shares being redeemed.

The important fact in the operations of the mutual fund underwriter is that the customer's purchase moneys are transmitted to the fund's custodian bank and none is retained by the underwriter. The period of possible jeopardy to any customer by reason of the underwriter's possession is thus limited to the time which it takes for the underwriter to process the trade -- a maximum period usually

* Study of Unsafe and Unsound Practices of Brokers and Dealers, SEC, Vol. 2, Chapter IV, Page 16.

** The mutual fund underwriter contracts with the fund to arrange for the distribution of the shares of the fund to the public. Often the underwriter and the fund's investment adviser are a single entity. Where they are separate companies, they are usually, but not always, under common control. Because the underwriter distributes securities, i.e., the shares of the fund, it is required to register as a broker-dealer under the Securities Exchange Act of 1934. A mutual fund underwriter usually distributes the shares only of the one or more funds in a particular fund group.

of from one to three days. Customers' funds and securities, therefore, do not come to rest for an indefinite period of time in the hands of the underwriter.

Not only does the mutual fund underwriter derive no economic benefit from holding customers' money or securities, but so far as the underwriter's activities are concerned, the risk to mutual fund investors is restricted to items in transit. The SIPC Fourth Annual Report for 1974 (page 8) confirms the finding in the SEC study and admits that mutual fund underwriters do not "hold" customers' securities or funds but merely "handle" them. The type of risk involved is primarily that of possible misappropriation or embezzlement and is not a risk associated with the deliberate and continuing use by a broker-dealer in its business of a customer's cash or securities. The misappropriation or embezzlement type of risk is guarded against by fidelity bonds which mutual fund underwriters maintain.

It is not at all surprising that not a single claim, so far as we know, has been made against SIPC with respect to the activities of a mutual fund underwriter.

The Retail Broker-Dealer

The retail broker-dealer is the person who most often deals directly with the public in the sale of mutual fund shares. The recommendation to repeal the exemption from the SIPC assessment base of mutual fund revenues apparently stems from the fact that in the 6 1/2 year period after SIPC was created, SIPC advanced money

to meet the claims of some 50 customers who suffered losses on account of mutual fund transactions with eight small retail brokerage firms. The cost to SIPC of these claims aggregated about $190,655. These small claims are <u>de minimis</u> when contrasted with losses claimed by all brokerage firm customers during the same period. Total SIPC advances to such customers were about $43.9 million and these claims have been made, not by about 50, but by some 105,000 customers. In other words, over a 6 1/2 year period, alleged mutual fund loss claims involving retail broker-dealers amounted to 0.05% of the total number of claims and 0.43% of the total dollar value of all advances. Viewed another way, while investors' mutual fund sales and redemptions for the same 6 1/2 year period amounted to over $51 billion, the $190,000 of SIPC advances amounted to 0.0004% of this total volume.

There is no evidence to indicate that the losses occurred because of any practice on the part of the eight firms to use customers' money or securities during the course of their normal business. Rather, the evidence is that the losses occurred by reason of simple misappropriation.*

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* The names of 39 claimants were supplied to us by SIPC. We sent each claimant a questionnaire seeking the details of his loss. Fifteen of these 39 claimants responded and their responses dealt with transactions by three of the seven brokerage firms involved. It appears from these responses that the losses occurred because the broker-dealer pocketed the money received from his customer and then either failed to even advise the mutual fund underwriter of the order or confirmed the order to the underwriter but sent a bad check to pay for the shares.

Experience Justifies the Exemption

We think that even 50 cases of loss to mutual fund customers through some sort of misconduct is 50 cases too many. Although the figure is *de minimis* from the legislative standpoint, proper remedial steps should be taken, and we will discuss that issue in a moment.

We have analyzed the SIPC premiums which would have been collected through 1976 on account of mutual fund activities if there had been no exemptions in the original Act. (We do not have sufficient data available to include variable annuities in our analysis.) Our estimate shows that the assessments on the mutual fund industry over this period would have amounted to some $10,308,537. The components of these figures are as follows:

Dues on account of retail broker-dealer transactions -	$ 3,827,575
Dues from underwriters' sales revenues -	$ 2,547,819
Total: dues from sales revenues -	$ 6,375,394
Dues from mutual fund advisory and other advisory fees -	$ 3,933,143 *
Total SIPC dues from fund industry -	$ 10,308,537

These figures taken alone should be conclusive on the issue of the propriety of the exemptions. The total so far exceeds the losses claimed by SIPC, the disproportion so immense, that it is obvious that it would have been absurdly unfair not to have included the exemptions in the original legislation. It would be just as absurd to repeal them now.

* This figure has been computed solely on the basis that the exemptions would be deleted. If the Act is also amended to include a new consolidation provision, this figure would exceed $8 million, and therefore the total would exceed $14 million. See page 13 below.

In pointing to a remedy more in keeping with the problem we refer our own inquiry into the circumstances surrounding the $190,000 in losses to mutual fund customers. These losses occurred not through any routine business practice but because of isolated instances of apparent dishonesty. It seems clear that such losses might well have been obviated if the broker-dealers in question had appropriate fidelity bonds. We urged in our testimony two years ago and take this occasion to re-emphasize our position that the SEC, after appropriate study, should adopt such changes in existing bonding requirements as to remedy even the minor problem which may exist. The nostrum of compulsory SIPC membership is thus unnecessary to cure a specific and limited problem. Moreover, as we now show, such membership would also be grossly inequitable in terms of what may be termed the profit side of the ledger, as well as leading to assessments which would be disproportionate when measured against losses.

RESTRICTING SIPC MEMBERSHIP TO BROKER-DEALERS WHO PROFIT FROM USING CUSTOMERS' FUNDS AND SECURITIES AND BASING ASSESSMENTS ON SUCH ACTIVITIES IS WHOLLY APPROPRIATE

When Congress was considering the legislation which established SIPC a number of alternatives to an insurance scheme which would not have involved the creation of a new governmental agency were also discussed. One such alternative would have been to bar broker-dealers from using customers' funds and securities in the course of their own business by requiring that they be segregated or held in a custodian bank as is the case with mutual funds. Another alternative would have been to impose high reserve requirements

against the value of customers' securities and free credit balances. The adoption of either of the alternative solutions would have made SIPC unnecessary as a continuing institution since the problem -- use of customers' funds and securities by brokerage firms -- would have been eliminated at the source. Neither of these approaches would have had any impact at all on the mutual fund and variable annuity industries. As pointed out above, this Committee found in 1970, the SEC study confirmed, and SIPC admits, that mutual fund and variable annuity investors do not ordinarily leave free credit balances with broker-dealers. Moreover, variable annuity contracts cannot be hypothecated by broker-dealers in the manner of typical securities, and more than 90% of current mutual fund sales do not involve the issuance of stock certificates.*

Although the surgical solution to the risk creating activities of broker-dealers would not have affected the mutual fund or variable annuity industries, its impact on the general securities business would have been enormous. Chapters II and IV of the SEC Study of Unsafe and Unsound Practices make abundantly clear the enormous importance to brokerage firms, most notably stock exchange members, of their ability to use customers' funds

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* In this regard, the mutual fund industry has advanced towards the "certificateless" society that is still the subject of discussion today throughout the rest of the securities industry.

and securities in their business.*

The economic value to brokerage firms of their use of customers' funds and securities has been substantial over the years. We have included a table covering the years 1970 through 1976 (the years in which SIPC was operative) showing estimates of revenues derived by brokerage firms which arise in connection with their use of customers' assets and the percentage of total revenues which this represents.

BROKER-DEALER FIRMS WITH GROSS REVENUE OF $500,000 OR MORE*

Year	No. of Firms	Gross Revenue (In Millions)	Customer Net Credit Balances End of Year (In Millions)	Interest Income on Customer Accounts (In Millions)	Interest Income on Customer Accounts Percent of Gross Revenue
1976	N/A	$ 8,500	$ 2,023	$ 550	6.5%
1975	764	6,996	1,733	591	8.4
1974	609	5,065	1,732	622	12.3
1973	652	5,250	2,184	621	11.8
1972	817	6,729	2,150	527	7.8
1971	788	6,583	2,104	364	5.5
1970	655	4,747	2,126	379	8.0

* Data for 1970-75 obtained from tables shown on pages 4 and 5 of the SEC's Statistical Bulletin, April 1977, Vol. 36, No. 4; Data for 1976 are preliminary estimates.

Although it cannot be stated what percentage of these revenues would not have been generated if strict segregation of customers' assets had been required, it is certain that the ability to use these free credit balances and hypothecate investors' securities is the chief ingredient of the "tremendous leverage" which produces this income. Moreover, while there are

* As the study states: "To a large extent, the tremendous leverage available to many broker-dealers has come from their ability to rely on customers' funds and securities in the financing [of their businesses]...Normally, leverage to the degree that exists in the financial structure of broker-dealers would not be possible if customers' funds and securities were not available and these firms had to rely on the usual sources of financing available to other businesses." (Chapter II, page 64).

no published profit data associated with these revenues, the figures are so large that they speak for themselves. Brokerage industry assessments paid to SIPC are a small price indeed when measured against the $3.5 billion generated since 1970 through activities which were preserved through the legislation which made SIPC insurance available. In contrast, the mutual fund and variable annuity industries generate no revenues whatsoever from these activities. It would be shocking and indeed ludicrous to compel the mutual fund and variable annuity industries to pay insurance premiums to protect the profits of others flowing from activities in which they do not engage. This is wholly aside from the demonstrated fact, as discussed above, that the risk of loss created by mutual funds and variable annuities are by any standard *de minimis*.

SIPC SHOULD NOT BE PERMITTED TO INCLUDE IN ITS ASSESSMENT BASE ADVISORY FEES OF INVESTMENT ADVISERS WHO ARE NOT BROKER-DEALERS

The present consolidation provisions of the Act require the inclusion in the gross revenues of a broker-dealer member of SIPC and the revenues of any subsidiary of the member. H.R. 8331 (but not, it should be noted, the 1975 version of the Bill) contains a provision extending this consolidation requirement to all entities under common control with a broker-dealer. Whatever theoretical justification may be offered in support of this provision, its main practical effect would be to impose SIPC membership assessments on a number of investment advisers who are related to mutual fund organizations, but whose business it is to render advice to private -- i.e., non-mutual fund -- clients.

When the business of providing investment advice is not conducted within the offices of a broker-dealer doing a general securities business or by a wholly-owned subsidiary of such a broker-dealer, it is hard to see how there can be any conceivable benefit to the clients of the adviser from SIPC assessments -- even though these assessments probably will be passed on to these clients. If SIPC has been able to come forward with only *de minimis* losses on account of mutual fund retail transactions it has not, as far as we know, shown any instances of harm to advisory clients. However, the costs of this proposal will be enormous. We were not aware of this new provision until we actually received a copy of H.R. 8331 less than two weeks ago and we have not been able to conduct a detailed study of its consequences. However, our best estimate is that the $3,933,143 in assessments which would have been imposed on advisers if the mutual fund and variable annuity exemptions were deleted, would have exceeded $8 million had the original consolidation provisions in the Act tracked the present proposal. When this proposal is looked at cumulatively with the provisions which would repeal the mutual fund and variable annuity exemptions, it can be readily seen that H.R. 8331 is not merely corrective legislation which seeks to straighten out gaps and conceptual inconsistencies in the Act. It transforms SIPC into an agency whose scope goes far beyond the need which was demonstrated in 1970.

CONCLUSION

In summary, events have proved that Congress was clearly right when it refused in 1970 to force mutual fund underwriters to join SIPC. These underwriters do not use customers' money

or securities in their business -- no claim against SIPC on account of a fund underwriter has ever been made. Under these circumstances it would have been monstrously unfair for these underwriters to pay the almost $6.4 million it would have cost in assessments had their membership been mandatory. There is nothing at present or in the foreseeable future to justify a change in the earlier view of Congress.

Further, the proposed new consolidation provision would subject investment advisers to private clients to SIPC assessments, although their businesses obviously do not create the risks which led to the creation of SIPC.

On the level of the retail broker-dealer, we think that the claims that SIPC has paid in connection with mutual fund trades are legislatively *de minimis* and that the cure is not to saddle the small retail broker-dealer with assessments on mutual fund revenues, but to tighten the regulatory process, possibly in the area of fidelity bonds.

We believe these exemptions were wisely legislated and should not be repealed or diluted.

We appreciate this opportunity to present our views.

Public Securities Association
One World Trade Center, Suite 5271
New York 10048, Telephone: 212-466-1900

April 21, 1978

The Honorable Harrison A. Williams, Jr.
Chairman
Securities Subcommittee
Senate Committee on Banking, Housing and Urban Affairs
352 Russell Senate Office Building
Washington, D.C. 20510

Re: Securities Investor Protection Act - Amendments of 1977 (H.R. 8331)

Dear Senator Williams:

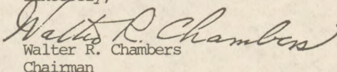
The Public Securities Association (PSA) is pleased to submit its comments concerning the Securities Investor Protection Act Amendments of 1977 (H.R. 8331). We respectfully request that our comments be incorporated into the record developed on the bill by the Securities Subcommittee.

PSA believes that H.R. 8331 contains important provisions affecting the investing public and members of the Securities Investor Protection Corporation (SIPC) that will improve the Securities Investor Protection Act of 1970 (1970 Act). For example, the bill would grant a trustee in a liquidation proceeding the authority to promptly satisfy customer claims in a way that would give the customer what he had when the firm stopped doing business. Other provisions of the bill are designed to enable the trustee and SIPC to dispose of claims under procedures that would result in reduced administrative expenses. PSA believes these changes are necessary and appropriate. Thus, we support their adoption by the Subcommittee.

PSA also supports the continued exclusion in Section 15 of H.R. 8331 of revenues received by a broker or dealer in connection with the distribution of shares of a unit investment trust from the definition of "gross revenues from the securities business" for the purpose of determining SIPC member assessments. We believe that this exclusion is consistent with the intent of the 1970 Act and should be retained in any amendments to the Act.

PSA believes that H.R. 8331 as passed by the House of Representatives would materially improve the 1970 Act. Therefore, we encourage favorable action on the bill by the Securities Subcommittee.

Sincerely,



Walter R. Chambers
Chairman

WRC:jm

Statement of the Securities Industry Association
Hearings on H.R. 8331, Amendments to the Securities Investor
Protection Act of 1970
before the
Subcommittee on Securities
Committee on Banking, Housing and Urban Affairs
United States Senate

April 25, 1978

The Securities Industry Association (SIA) submits the following statement on this legislation for the record.

SIA represents approximately 500 leading investment banking and brokerage firms headquartered throughout the United States which collectively account for approximately 90% of the nation's securities transactions conducted in this country. The business of our members includes retail brokerage conducted on behalf of 25 million shareholders, institutional brokerage, over-the-counter market making, various exchange floor functions, and underwriting and other investment banking activities conducted on behalf of corporations and governmental units at all levels.

We write to express our total support of H.R. 8331 as passed by the House of Representatives the provisions of which we believe enhance investor protection and provide for fair treatment for all firms engaged in the securities business.

The central purpose of the proposed amendments is to correct the problems that developed as SIPC began to liquidate debtor members and indemnify public customers. It became apparent very early in the life of SIPC that the 1970 legislation was far too rigid for the efficient handling of many brokerage liquidations. The Act did not contemplate the complexities of such industry phenomena as clearing corporations, fungible securites, continuous net settlement accounts, and omnibus accounts. Accordingly, liquidations were lengthy

and cumbersome, customers became disillusioned, and final settlements were inordinately protracted. The public was unhappy with the indemnification procedures and trustees, because of their inability to exercise routine discretion or business judgments due to the rigidity of the Act, were unable to be responsive to the many unique situations which occurred on a daily basis during the liquidation procedure.

The liquidation of Weis Securities, Inc., a large New York Stock Exchange member with over 35,000 public and institutional accounts, demonstrated conclusively the inflexibility of the 1970 Act and how costly, inefficient, and unsatisfactory it was to the public investor.

Since many clients were receiving indemnification in cash instead of securities and because their accounts were frozen for protracted periods of time, it has become apparent that what the public customer wants is the speedy delivery of his account intact and not protection resembling insurance benefits.

In order to achieve these goals and for the purpose of expediency and economy, new flexible statutory guidelines are needed to allow SIPC and trustees to exercise discretion to make customers whole quickly and with minimum expense. SIPC must be given such additional authority and discretion as are necessary to enable it to perform its role more effectively and efficiently and thereby to assist in maintaining investor confidence.

The provisions in H.R. 8331 will achieve the following goals:

- Added flexibility and discretion for trustees;
- Improved allocation and liquidation procedures;
- Simplified procedures for the liquidation of smaller and/or totally bankrupt estates;

- Reduced liquidation expenditures;
- Revised provisions for bulk delivery of securities to solvent members, maintenance of customer margin accounts, allowances for customer operation of accounts during a liquidation proceeding, and provisions for clients to receive the maximum amount of securities feasible in order to preserve their accounts as near as possible to their filing date status;
- Added ability of SIPC to maintain lines of credit and to arrange for bridge financing as well as to guarantee delivery of securities in certain situations;
- Expanded authority of SIPC to operate the business of a debtor long enough to realize some value from the operation of his going business as well as the sale of certain fixed assets.

The foregoing, together with a host of guidelines to reduce and simplify the legal procedures involved in a liquidation, are important measures incorporated in the Securities Investor Protection Amendments of 1977 which will correct the inadequacies of the present law. We fully support these measures.

The SIA, in its testimony before the House Subcommittee on Consumer Protection and Finance, supported the language of Section 14 regarding advertising, and the broadened definition of "gross revenues for security business" to include commissions and fees earned from the sale of mutual fund shares, and from the sale of variable annuities and the broadened definition of "securities" to include money market instruments. We believe that the House passed legislation represents an effective compromise in both of these areas, and we fully support the language of the House passed bill.

Finally, we wish to call attention to a notable achievement of SIPC which we would expect to be continued. That achievement is the fulfillment by the SIPC Board of its responsibilities without establishing an extensive and expensive bureaucracy. We understand that SIPC has covered its administrative

expenses for its internal operations by using 1/2 of the interest income SIPC has earned on its investments. The SIPC Board, with industry participation, has performed its job in an outstanding manner and deserves, in our view, public acknowledgement of the achievement and congratulations.

28-082 O - 78 - 15

THE New York Stock Exchange

William M. Batten
Chairman and
Chief Executive Officer

April 25, 1978

The Honorable Harrison A. Williams
United States Senate
352 Russell Senate Office Building
Washington, D.C. 20510

Dear Mr. Chairman:

The New York Stock Exchange appreciates this opportunity to express to you our strong support for H.R. 8331, the Securities Investor Protection Act Amendments of 1978, and commends your Subcommittee for its timely consideration of this legislation, which we feel will provide needed improvements in the Securities Investor Protection Act of 1970.

Having long supported the goals to which this legislation is dedicated, the Exchange believes that prompt enactment of these amendments, as passed by the House of Representatives, will give this law the vitality it needs to respond to the current challenges of its mandate. While there have been a few changes in H.R. 8331 as it has progressed through this Congress, the bill remains essentially the legislative embodiment of the report of the special SIPC Task Force in the summer of 1974. Just as we supported those recommendations, believing that they would enhance substantially investor protection and confidence, so do we now support the legislation before you.

You are currently receiving other testimony and comment, including specifically an analysis from the Securities Investor Protection Corporation -- the agency charged with administering the Act, discussing in detail how each of the proposed amendments before you will improve current law. Therefore, we will not burden your record with an additional recitation of our views on each of these issues, but rather do respectfully request your approval of H.R. 8331 in its present form.

These amendments will greatly increase the facility of restoring accounts to customers in the event of failure of larger brokerage firms. Although we are convinced that the 1968-70 style failures of broker-dealers are now

The Honorable Harrison A. Williams
Page Two

precluded by basic changes in industry practice, there still remains the possibility of failure arising from fraud or sudden financial catastrophe. To us, it is therefore of great urgency that the Securities Investor Protection Act be amended promptly in order to be prepared for the unexpected.

These amendments also will reduce administrative costs and increase customer protection in SIPC liquidations of smaller firms. Although the failures of smaller firms also have been considerably reduced, they do occur still. The customers of firms which may fail in 1978 and in later years should not be deprived of the benefits of these amendments.

There is one feature of the amendment package before you, Mr. Chairman, which we feel deserves special emphasis, because it will serve particularly to enhance investor confidence. I refer to the provision which will double the amount of money which SIPC can advance to a trustee for the protection of any one customer's account. As you know, under current law, there is a $50,000 limit for securities, with a maximum of $20,000 to satisfy a claim for cash, as opposed to a claim for securities. The legislation before you would provide coverages of $100,000 and $40,000 respectively. The Exchange strongly endorses these proposed increases, believing it to be important that this higher level of protection be afforded SIPC customers at the same ratio which exists under present law.

Mr. Chairman, the New York Stock Exchange hopes these comments will be useful to your Subcommittee in your deliberation of H.R. 8331. As always, we are available to you and your staff on this or any related issue affecting the confidence and protection of the investor community.

Best wishes,

[signature]

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

DIVISION OF
MARKET REGULATION

April 26, 1978

Howard A. Menell
Assistant Counsel
Subcommittee on Securities
Committee on Banking, Housing
and Urban Affairs
5300 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Howard:

As you are aware, the Commission testified before the House Subcommittee on Consumer Protection and Finance during its hearings last August on H.R. 8331. Yesterday during his testimony before the Securities Subcommittee on the same bill, Chairman Williams offered to furnish a copy of the statement and comments submitted to the House Subcommittee. I have enclosed that material.

Sincerely,

Linda Kurjan
Staff Attorney

Enclosure

TESTIMONY OF COMMISSIONER PHILIP A. LOOMIS BEFORE THE SUBCOMMITTEE ON CONSUMER PROTECTION AND FINANCE OF THE HOUSE COMMITTEE ON INTERSTATE AND FOREIGN COMMERCE ON H.R. 8331, NINETY-FIFTH CONGRESS, FIRST SESSION, 1977.

AUGUST 2, 1977

MR. CHAIRMAN AND MEMBERS OF THE SUBCOMMITTEE, IT IS A PLEASURE TO APPEAR BEFORE YOU TODAY TO PRESENT THE COMMISSION'S VIEWS ON THE PROPOSED AMENDMENTS TO THE SECURITIES INVESTOR PROTECTION ACT OF 1970.

AS YOU KNOW, THE COMMISSION HAS SUPPORTED THIS LEGISLATION FOR A LONG TIME. WHEN THE COMMISSION FORWARDED TO CONGRESS ITS COMMENTS ON SIPC'S FIRST ANNUAL REPORT, PROBLEMS WITH THE ACT HAD ALREADY ARISEN. BY THE TIME OUR SECOND LETTER OF COMMENT WAS FORWARDED, WE RECOGNIZED THAT FURTHER LEGISLATION WOULD BE NECESSARY ALTHOUGH THE APPROPRIATE SCOPE OF THAT LEGISLATION WAS NOT YET CLEAR. BY THE TIME OF SIPC'S THIRD ANNUAL REPORT, THE SIPC TASK FORCE HAD BEEN APPOINTED AND HAD BEGUN ITS WORK. WE APPLAUDED THE ESTABLISHMENT OF THAT TASK FORCE AND OUR STAFF DEVOTED CONSIDERABLE TIME TO ITS DELIBERATIONS. TWO YEARS AGO, THE RECOMMENDATIONS OF THAT TASK FORCE WERE FIRST CONSIDERED BY THIS SUBCOMMITTEE.

Legislation was not enacted at that time. In the intervening period, SIPC has initiated only seven liquidations, all of which have been relatively small. Because of this, and because SIPC has been effective in satisfying customer claims as quickly and completely as the law would permit, there has not been a sense of urgency about the enactment of this legislation. Nevertheless, as a few statistics point out, the safeguards provided under the SIPC Act are vital to the protection of public investors and the maintenance of confidence in the United States securities markets. During its existence, SIPC has returned to more than 100,000 customers approximately $277 million in property and has advanced more than $53 million from the SIPC fund to satisfy customer claims and pay expenses.

We hope that SIPC will never again be called upon to initiate forty liquidations in a single year as it did in 1972. Since the passage of the SIPC Act, the Commission has taken various steps to strengthen the financial responsibility standards of broker-dealers, to expedite the processing of securities transactions, and to improve the entry standards in the securities industry. And Congress has been vigilant in overseeing our progress and providing us with the authority to make needed changes. We believe these

DEVELOPMENTS AS WELL AS THE IMPROVEMENTS WHICH THE SELF-REGULATORY ORGANIZATIONS HAVE EFFECTED IN THE OVERSIGHT OF THEIR MEMBERS HAVE DONE MUCH TO REDUCE THE INCIDENCE OF BROKER-DEALER INSOLVENCY AND HAVE, IN GENERAL, ASSURED THAT SUCH INSOLVENCY DOES NOT RESULT IN THE LOSS OF CUSTOMER FUNDS AND SECURITIES.

NEVERTHELESS, THE SIPC ACT MUST BE DESIGNED NOT FOR A QUIET PERIOD IN TERMS OF BROKER INSOLVENCY SUCH AS THE PRESENT, BUT FOR THE POSSIBILITY, HOWEVER REMOTE, OF SERIOUS FUTURE PROBLEMS. THE ACT ALSO MUST BE DESIGNED TO MINIMIZE THE FINANCIAL BURDEN ON SIPC MEMBER FIRMS WHERE THAT CAN BE ACCOMPLISHED WITHOUT SACRIFICING CUSTOMER PROTECTION. IT IS CLEAR THAT THE CURRENT SIPC ACT DOES NOT MEET THESE OBJECTIVES IN SOME WAYS, NOR DOES IT PROVIDE SIPC WITH THE FLEXIBILITY TO EFFECT THE MOST EFFICIENT SOLUTIONS TO THE BROAD RANGE OF PROBLEMS WHICH MAY CONFRONT IT.

WHILE WE HAVE COMMENTS ABOUT SPECIFIC PROVISIONS OF THE AMENDMENTS, THE COMMISSION WISHES TO MAKE CLEAR ITS STRONG SUPPORT FOR THE PROPOSED LEGISLATION. AS I NOTED TWO YEARS AGO, IN THE OVERVIEW, IT CARRIES OUT THE REASONED AND THOUGHTFUL RECOMMENDATIONS OF THE SIPC TASK FORCE AND WOULD ASSURE THAT THE PROTECTIONS PROVIDED UNDER THE SIPC ACT WOULD MORE CLEARLY MEET THE REASONABLE

EXPECTATIONS OF PUBLIC CUSTOMERS WITHIN THE LIMITS OF PROTECTION PROVIDED IN THE ACT. MOST OF THE DISAGREEMENTS THAT EXISTED BETWEEN SIPC AND THE COMMISSION IN 1975 HAVE BEEN RESOLVED. IN SEVERAL OTHER CASES, THE COMMISSION HAS RECEDED FROM POSITIONS IT TOOK BEFORE THIS SUBCOMMITTEE IN 1975 BECAUSE DISCUSSIONS WITH SIPC, MEMBERS OF THE FINANCIAL COMMUNITY, OR OTHER COMMENTORS OR LEGAL SCHOLARS HAVE LESSENED OUR CONCERNS ABOUT THESE PROBLEMS OR CONVINCED US THAT NO SIGNIFICANT HARM WOULD RESULT.

I HAVE LIMITED MY TESTIMONY, IN GENERAL, TO A DISCUSSION OF SEVERAL BROAD POLICY ISSUES WHICH I BELIEVE SHOULD BE CONSIDERED BY THE SUBCOMMITTEE IN ENACTING THIS LEGISLATION. IN ADDITION, MR. CHAIRMAN, I WISH TO SUBMIT TO THE SUBCOMMITTEE AT THIS TIME, A MEMORANDUM WHICH SETS FORTH THE COMMISSION'S POSITION ON A NUMBER OF SECTIONS OF THE PROPOSED AMENDMENTS WHICH WE BELIEVE SHOULD BE MODIFIED. THESE REPRESENT THE FEW REMAINING AREAS WHERE THE VIEWS OF THE COMMISSION AND SIPC DIFFER OR REFLECT NEW PROBLEMS WHICH WE FOUND IN REVIEWING H.R. 8331. IN ADDITION, I WISH TO SUBMIT A FEW TECHNICAL COMMENTS PREPARED BY OUR STAFF.

THE BILL WOULD REMOVE THE EXCLUSION FROM SIPC MEMBERSHIP FOR FOUR CLASSES OF BROKER-DEALERS -- THOSE DEALING EXCLUSIVELY IN THE SALE OF MUTUAL FUNDS, VARIABLE ANNUITIES, 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 THE SUBCOMMITTEE IS AWARE, THESE EXCLUSIONS HAVE BEEN THE SUBJECT OF CONSIDERABLE CONTROVERSY WHICH DATES BACK TO CONGRESSIONAL CONSIDERATION OF THE SIPC ACT IN 1970.

THE EXCLUSION OF THESE BROKER-DEALERS FROM SIPC MEMBERSHIP WAS PROMPTED BY THE IDEA THAT BECAUSE THEY RARELY HELD CUSTOMERS' FUNDS OR SECURITIES, THEIR CUSTOMERS DID NOT NEED SIPC PROTECTION, AND THEREFORE, THEY SHOULD NOT HAVE TO PAY SIPC ASSESSMENTS. ONCE THIS WAS DONE, IT WAS DEEMED NECESSARY TO EXCLUDE REVENUES FROM THE SAME SOURCES AS A BASIS FOR SIPC ASSESSMENTS FOR BROKER-DEALERS WHO WERE MEMBERS OF SIPC IN ORDER TO AVOID CREATING A COMPETITIVE INEQUALITY BETWEEN MEMBERS AND NON-MEMBERS IN THESE FIELDS.

SIPC ADVISES US THAT OVER THE PAST SEVEN YEARS, IT HAS EXPENDED APPROXIMATELY $190,000 TO PROTECT CUSTOMERS IN RELATION TO MUTUAL FUND CLAIMS AND HAS RETURNED ANOTHER $70,000 IN PROPERTY RELATED TO MUTUAL FUND CLAIMS

TO CUSTOMERS. WHILE THIS IS NOT A LARGE AMOUNT, SIPC ARGUES THAT BECAUSE SOME LOSSES DO OCCUR, MUTUAL FUND REVENUES SHOULD BE SUBJECT TO ASSESSMENT. IN ADDITION, SIPC ARGUES THAT THE MAINTENANCE OF PUBLIC CONFIDENCE IN THE MARKETS AS A RESULT OF THE SIPC ACT BENEFITS ALL BROKER-DEALERS AND, ACCORDINGLY, ALL BROKER-DEALERS SHOULD PAY ASSESSMENTS.

THERE IS ANOTHER ASPECT TO THIS PROBLEM, HOWEVER. PERSONS WHO DEAL WITH BROKER-DEALERS ENGAGED EXCLUSIVELY IN THE DISTRIBUTION OF MUTUAL FUNDS HAVE NO PROTECTION IF THOSE BROKER-DEALERS MISAPPROPRIATE THEIR FUNDS OR SECURITIES. IN MAY OF THIS YEAR, THE COMMISSION BROUGHT AN ACTION AGAINST SUCH A BROKER-DEALER IN TENNESSEE ALLEGING VIOLATIONS OF, AMONG OTHER THINGS, THE ANTI-FRAUD PROVISIONS OF THE FEDERAL SECURITIES LAWS. SUBSEQUENTLY, A RECEIVER WAS APPOINTED. ALTHOUGH OUR INVESTIGATION IS NOT YET COMPLETE, THE INDICATIONS ARE THAT AT LEAST NINE CUSTOMERS HAVE LOST SOME $200,000 WITH THIS BROKER-DEALER. THOSE CUSTOMERS CLEARLY ARE AS MUCH IN NEED OF THE PROTECTION PROVIDED UNDER THE SIPC ACT AS ARE CUSTOMERS OF BROKER-DEALERS ENGAGED IN A GENERAL SECURITIES BUSINESS. MUTUAL FUNDS ARE TRADITIONALLY AN INVESTMENT MEDIUM FOR THE SMALL AND FREQUENTLY UNSOPHISTICATED INVESTOR AT WHOM THE SIPC ACT IS MOST CLEARLY DIRECTED. THE COMMISSION BELIEVES THAT ALL

PUBLIC CUSTOMERS OF REGISTERED BROKER-DEALERS SHOULD BE PROTECTED AGAINST THEIR BROKERS' INSOLVENCY.

SIPC HAS SUGGESTED TO THE SUBCOMMITTEE THAT ASSESSMENT OF MUTUAL FUND REVENUES IS THE QUID PRO QUO FOR PROTECTION OF CUSTOMERS AGAINST LOSSES RELATING TO MUTUAL FUNDS. WE ARE SYMPATHETIC TO THE ARGUMENT THAT SIPC SHOULD NOT HAVE TO EXPEND MONIES TO PROTECT CUSTOMERS IN RELATION TO SECURITIES FROM THE TRADING OF WHICH IT DERIVES NO REVENUES. BUT THERE IS MERIT IN THE ARGUMENTS ON BOTH SIDES.

THE MUTUAL FUND INDUSTRY AND OTHERS AFFECTED POINT OUT THAT THE ASSESSMENTS WHICH WOULD BE LEVIED WOULD BE GROSSLY DISPROPORTIONATE TO SIPC'S LOSS EXPERIENCE WITH MUTUAL FUND DEALERS OR PERSONS SELLING VARIABLE ANNUITIES.

WE BELIEVE THERE IS A REASONABLE SOLUTION. SIPC IS REQUIRED TO LEVY ASSESSMENTS ON THE BASIS OF A PERCENTAGE OF GROSS REVENUES OF A FIRM ONLY WHEN THE SIPC FUND IS BELOW $150 MILLION. IT IS EXPECTED THAT THE GOAL OF $150 MILLION WILL BE REACHED THIS YEAR. THEREAFTER, SIPC CAN VARY ASSESSMENTS ON THE BASIS OF RISK, AMONG OTHER FACTORS, AND IS DIRECTED TO LEVY ASSESSMENTS AT A RATE SUFFICIENT ONLY TO MAINTAIN THE FUND AND TO COVER CURRENT OPERATIONS.

ACCORDINGLY, WE RECOMMEND THAT THE SUBCOMMITEE REMOVE THE CURRENT EXCLUSIONS IN THE SIPC ACT AND REQUIRE ALL REGISTERED BROKER-DEALERS TO BE MEMBERS OF SIPC. CONCOMITANTLY, THE ASSESSMENT EXCLUSION SHOULD ALSO BE REMOVED. WE SUGGEST, HOWEVER, THAT THE SUBCOMMITTEE URGE SIPC AND REPRESENTATIVES OF THE AFFECTED BROKER-DEALERS TO DISCUSS THE SITUATION AND TO DEVELOP AN ASSESSMENT PLAN WHICH WILL IMPOSE UPON THESE BROKER-DEALERS ASSESSMENTS WHICH ARE AT LEAST GENERALLY RELATED TO THE RISK INVOLVED AND TO THE LOSS EXPERIENCE. WE BELIEVE THIS CAN AND SHOULD BE DONE UNDER SIPC'S EXISTING STATUTORY AUTHORITY AND DO NOT BELIEVE IT IS NECESSARY TO AMEND THE ASSESSMENT PROVISIONS OF THE STATUTE TO ACCOMPLISH THIS END.

THERE IS ANOTHER AREA WHERE THE SIPC ASSESSMENT STRUCTURE MAY BE A PROBLEM. WE ARE ADVISED THAT IN THE PAST SIPC MEMBERS HAVE NOT, IN GENERAL, PAID ASSESSMENTS ON REVENUES RECEIVED IN CONNECTION WITH TRANSACTIONS IN MONEY MARKET INSTRUMENTS -- CERTIFICATES OF DEPOSIT, COMMERCIAL PAPER, BANKERS' ACCEPTANCES AND TREASURY BILLS -- BECAUSE THESE REVENUES WERE NOT DEEMED TO BE GROSS REVENUES FROM THE SECURITIES BUSINESS. AT THE SAME TIME, SIPC HAS PROVIDED CUSTOMER PROTECTION WITH REGARD TO SUCH

INSTRUMENTS. THE DEFINITION OF SECURITIES WHICH IS INCORPORATED INTO H.R. 8331 INCLUDES MONEY MARKET INSTRUMENTS, AND, THEREFORE, SIPC MEMBERS WILL NOW BE REQUIRED TO PAY ASSESSMENTS ON REVENUES FROM THAT SOURCE. AS WITH REVENUES FROM MUTUAL FUNDS AND VARIABLE ANNUITIES, WE BELIEVE THAT, IF SIPC IS TO PROVIDE PROTECTION WITH REGARD TO MONEY MARKET INSTRUMENTS, IT SHOULD RECEIVE SOME ASSESSMENTS, BUT THE ASSESSMENT RATE NEED NOT BE EQUAL TO THE RATE IMPOSED ON OTHER SECURITIES REVENUES.

H.R. 8331 ALSO AMENDS SECTION 4(I)(2) OF THE SIPC ACT TO REQUIRE MEMBERS TO INCLUDE IN THEIR ASSESSMENT BASE SECURITIES REVENUES OF ENTITIES WHICH CONTROL, ARE CONTROLLED BY OR ARE UNDER COMMON CONTROL WITH SUCH MEMBER. THE AMENDMENT OF SECTION 4(I)(2) WOULD APPEAR, AMONG OTHER THINGS, TO (I) REQUIRE SIPC MEMBERS TO INCLUDE SECURITIES REVENUES OF FOREIGN AFFILIATES IN THEIR ASSESSMENTS, (II) BRING WITHIN THE AMBIT OF SIPC ASSESSMENTS SECURITIES REVENUES OF COMPANIES, SUCH AS INSURANCE COMPANIES, WHICH HAPPEN TO BE AFFILIATED WITH BROKER-DEALERS AND WHICH HAVE SECURITIES REVENUES, AND (III) IN COMBINATION WITH THE INCLUSION OF MONEY MARKET INSTRUMENTS IN MEMBERS' ASSESSMENTS, CAUSE SIPC MEMBERS TO PAY ASSESSMENTS ON TRANSACTIONS IN MONEY MARKET INSTRUMENTS CONDUCTED THROUGH UNREGISTERED AFFILIATES.

We believe that the amendment of Section 4(i)(2) should be examined carefully by the Subcommittee. The provision may have far reaching and possibly unintended effects on companies with large and complex corporate structures. If Section 4(i)(2) is enacted, the Subcommittee may wish to consider taking steps to mitigate the burden which would be placed on particular segments of the brokerage industry.

The bill provides a limitation of protection different than that recommended by the Task Force or included in the previous House and Senate bills. The 1975 legislation provided a limitation of $100,000 for each customer account with a limitation of $40,000 on claims for cash as distinct from securities. H.R. 8331 continues the $100,000 level of protection for securities but limits cash coverage to only $20,000. Although we understand that the Subcommittee may not wish to encourage public customers to deposit funds with broker-dealers for long periods of time, the effect of this provision may be to disable customers from freely trading in their securities accounts and frustrate the legitimate expectations of customers who did not deliberately deposit funds with broker-dealers.

When a customer sells securities, his claim from that time until settlement and delivery of the funds is a claim for cash. Under H.R. 8331, a customer with $100,000 in securities in an account would never be able to execute a sale for more than $20,000 of those securities without losing, in some part, his SIPC protection. While we recognize that a customer is not likely to sell an entire $100,000 position in a single transaction, we believe that the $20,000 limit is unnecessarily restrictive and might have unfortunate consequences for unwary public customers. We urge the Subcommittee to return to a $40,000 limitation for claims relating to cash.

Section 2 of the bill authorizes SIPC to exclude from membership any broker-dealer "whose principal business, in the determination of SIPC, taking into account business of affiliated entities, is conducted outside the United States or its territories or possessions. . . ." The Commission is most concerned about this provision, and we believe that it is not well drafted to accomplish its important end. SIPC is properly concerned that it not be made responsible for foreign broker-dealers whose assets are beyond its reach and in regard to whom it could not carry out a liquidation as directed by the statute. As drafted, however, the

PROVISION WOULD PERMIT SIPC TO EXCLUDE BROKER-DEALERS IN ITS UNFETTERED DISCRETION AND WITHOUT DIRECT REVIEW BY THE COMMISSION OR ANYONE ELSE. THE ONLY FORESEEABLE REVIEW OF SIPC'S ACTIONS WOULD BE A SUIT BY A CUSTOMER OF AN INSOLVENT BROKER-DEALER MAINTAINING THAT THE BROKER-DEALER SHOULD HAVE BEEN A MEMBER OF SIPC.

IN ADDITION, THE PROVISION CREATES THE POSSIBILITY THAT A UNITED STATES RESIDENT DEALING WITH A REGISTERED BROKER-DEALER IN UNITED STATES TERRITORY MAY FIND HIMSELF EXCLUDED FROM SIPC COVERAGE WHICH WE BELIEVE DOES NOT COMPORT WITH THE INTENT OF THE SIPC ACT. FOR EXAMPLE, IF A CANADIAN BROKER-DEALER WERE DOING $20 MILLION OF SECURITIES BUSINESS ANNUALLY, OF WHICH $5 MILLION OCCURRED IN THE UNITED STATES, SIPC APPARENTLY COULD EXCLUDE THAT BROKER-DEALER UNDER THIS PROVISION. AT THE SAME TIME, ANOTHER BROKER-DEALER WHO HAS A TOTAL BUSINESS OF $5 MILLION, ALL OF WHICH IT CONDUCTED IN THE UNITED STATES, WOULD BE A SIPC MEMBER. FROM THE STANDPOINT OF THE EFFECT ON UNITED STATES INVESTORS, HOWEVER, THERE IS NO DIFFERENCE BETWEEN THE TWO BROKER-DEALERS.

Because of the short time since introduction of this bill, we have not attempted to suggest to the Subcommittee a revision of Section 2. Rather, we urge the Subcommittee to re-examine this provision. We recommend the Subcommittee consider placing some review process over SIPC's discretion, and, in addition, require broker-dealers excluded from SIPC membership under this provision to make such disclosures to their customers as the Commission may require by rule. If the Subcommittee wishes, I would be happy to offer the services of our staff to assist the Subcommittee in redrafting Section 2.

I would like to note a potential problem with the rulemaking procedure provided in the bill. As you are aware, this procedure is modeled after Section 19(b) of the Securities Exchange Act which was enacted by the Securities Acts Amendments of 1975. The Commission's experience in administering Section 19(b) has led us to conclude that the fixed time frames provided in that section are, in some cases, too rigid and may create unnecessary burdens for both the Commission and the affected self-regulatory organizations. We considered suggesting certain revisions of the rulemaking procedure in the SIPC

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Act to deal with those problems, but concluded that there is an advantage to maintaining comparability between the two acts. The Subcommittee should be aware, however, that as the Commission gains additional experience in administering these provisions, we may wish to bring before the Subcommittee a proposal to revise the rulemaking procedures of both Section 19(b) and the SIPC Act.

Finally, SIPC has added a clause to the definition of "customer" which appears as Section 16(3) of the bill. The existing section excludes from customer status any person who has a claim for cash or securities which is part of the capital of the debtor or is subordinated to claims of creditors of the debtor. The added clause excludes such persons "notwithstanding that some ground might have existed for declaring such contract, agreement or understanding void or voidable in a suite between the claimant and the debtor."

When I appeared before this Subcommittee in 1975, I expressed some concern that while subordinated lenders in general should be excluded from SIPC coverage, there could be exceptional cases where we would want to grant a subordinated lender relief. I suggested that perhaps such

A PERSON COULD BE TREATED AS A CUSTOMER IF SIPC OR THE COURT DETERMINED, IN VIEW OF ALL THE CIRCUMSTANCES OF A PARTICULAR CASE, THAT IT WOULD BE EQUITABLE TO DO SO. I EXPRESSED THE VIEW THAT THIS MIGHT PROVIDE AN AVENUE FOR COVERING SPECIAL CASES WITHOUT OPENING UP SIPC PROTECTION TO THE CLAIMS OF THE MORE COMMON SUBORDINATED LENDERS WHO ARE PARTNERS OR QUASI-INSIDERS OF THE DEBTOR.

AT THE SAME TIME, I RECOGNIZED THAT THE PROVISION PROPOSED BY SIPC DOES NOT DENY THE SUBORDINATED LENDER THE RIGHT TO ATTEMPT TO RESCIND HIS CONTRACT. RATHER, IT MERELY DENIES HIM THE RIGHT TO CUSTOMER STATUS WHICH IS A SPECIAL PRIVILEGE CONGRESS HAS GRANTED TO THE PUBLIC IN THE SIPC ACT AND WHICH NEED NOT BE GIVEN TO ALL PERSONS WHO DEAL WITH THE DEBTOR.

ALTHOUGH I AM LESS CONVINCED THAN I WAS THAT IT IS NECESSARY TO PROVIDE FOR EXCEPTIONAL CASES, I BELIEVE THE SUBCOMMITTEE SHOULD LEAVE FLEXIBILITY IN THE STATUTE AND SHOULD NOT ENACT AN ABSOLUTE PROHIBITION AGAINST SUBORDINATED LENDERS REGAINING CUSTOMER STATUS.

IN CONCLUSION, MR. CHAIRMAN, LET ME REITERATE THE COMMISSION'S STRONG AND CONTINUING SUPPORT FOR THE PROMPT ENACTMENT OF THIS LEGISLATION. I WILL BE HAPPY TO RESPOND TO ANY QUESTIONS THE SUBCOMMITTEE MAY HAVE.

WRITTEN COMMENTS OF THE SECURITIES AND EXCHANGE COMMISSION ON H.R. 8331, 95TH CONGRESS, FIRST SESSION (1977), SUBMITTED TO THE SUBCOMMITTEE ON CONSUMER PROTECTION AND FINANCE OF THE COMMITTEE ON INTERSTATE AND FOREIGN COMMERCE OF THE HOUSE OF REPRESENTATIVES, AUGUST 2, 1977.

The Securities and Exchange Commission wholeheartedly supports H.R. 8331, a bill to amend the Securities Investor Protection Act of 1970 (the "SIPC Act"). The steps taken to increase the scope of customer protection and to limit the time required to satisfy customer claims are clearly in the public interest. We have certain comments on the bill, however.

Substantive Comments on H.R. 8331*

1. In amending Section 3(c)(2)(C)(ii) (H-4) regarding the appointment of SIPC directors, the disqualification of persons associated with any "other securities industry group" from serving as public directors of SIPC was deleted. In addition, it may be useful to modify the provision slightly to reflect the fact that registered clearing agencies are now self-regulatory organizations. There is also a technical error in the manner in which Section 3(a)(21) of the Securities Exchange Act was carried over. Finally, the proposed amendment combined with the existing language refers to "persons who are persons associated" etc.; the repeat is unnecessary. Accordingly, we suggest the following changes: (i) In lines 5 and 6, delete "persons." (ii) In line 6, add "member of a" before "national." (iii) In line 8, after "Act" add "or similarly associated with any self-regulatory organization or other securities industry group,".

2. Proposed Section 3(e)(2) (H-5) provides a rulemaking procedure for SIPC. While the Commission is generally satisfied with the proposed procedure, we have several technical comments principally designed to make the procedure parallel to Section 19(b) of the Securities Exchange Act.

(i) Proposed subparagraph (E) (H-8) sets forth the situations in which a proposed rule change may take effect summarily. Under subparagraph (ii), there may be instances when an emergency rule proposal becomes effective before it is filed with the Commission. In order to clarify that such a rule change, though already in effect, must be filed and reviewed under Section 3(e)(2), we recommend the following sentence be added to subparagraph (ii) (H-8, at line 19):

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* References to the pages of H.R. 8331 are denoted by "H" and the page number.

> "Any proposed rule change that takes effect under this subparagraph shall be filed promptly thereafter and reviewed in accordance with the provisions of Section 3(e)(2)(A)."

(ii) Subparagraph (E) also provides that the Commission may abrogate any rule change that becomes effective pursuant to the summary procedure within a sixty-day period that would run from the effective date of the rule change. Because the effective date is not necessarily the date of filing and may in fact be prior to the date of filing, we suggest that the deadline be calculated from the date the rule change is filed as is done in Section 19(b)(3)(C) of the Securities Exchange Act.

(iii) Finally, the abrogation procedure provides that the Commission may require the abrogated rule change to be refiled. This provision should be amended to clarify that the refiled rule change would also be subject to review in accordance with the usual procedures of Section 3(e)(2). This can be accomplished by inserting the words "and reviewed" after "refiled" in line 24 of H-8.

3. The proposed amendment to Section 4(e)(1) is intended to apply the prior trust provision to registered clearing agencies (H-11). The proposal is inapposite because clearing agencies were not self-regulatory organizations prior to 1970.

4. Section 4(g), which involves SEC loans to SIPC, as amended by H.R. 8331 (H-12), provides that any transaction fees imposed upon purchasers of equity securities are to be collected by the broker-dealer effecting the transaction "or by such other person as provided by the Commission by rule. . . ." The requirement that the collected fees be paid to SIPC in the same manner as assessments may be inappropriate with respect to other designated persons. Accordingly, we suggest that the phrase "or in such other manner as the Commission may by rule provide" be inserted following "assessments" in line 3 of H-13.

5. The phrase "with respect to such member" in line 8 of H-15 is unnecessary and may restrict the scope of pending Commission actions with which an application for a protective decree may be combined. We recommend deletion of the phrase.

6. Proposed Section 5(b)(2)(B)(iii) (H-18) provides that the court in which an application for a protective decree has been filed may, for an appropriate length of time pending issuance of the decree, stay enforcement of, but may not abrogate, the right of set-off under the Bankruptcy Act and the right to enforce a valid nonpreferential lien against the property of the debtor. The section also provides that the court may continue the stay upon appointment of the trustee but does not place limits on the length of the latter stay. The legislative history of the SIPC Act indicates that the Committee on Interstate and Foreign Commerce intended such a stay to be limited. In House Report 91-1613 which accompanied the SIPC Act in 1970, the Committee stated that the Court could stay these rights only "for an appropriate period of short duration." (at 10). The Subcommittee should be aware that as revised, Section 5(b)(2)(B)(iii) may be viewed by the banking community and others as constituting a substantive change in current law.

7. SIPC has, in administering the current Act, experienced a problem with respect to customers who deal with a broker-dealer after the filing date. Because of the manner in which "filing date" is defined (proposed Section 16(8), H-59), the filing date may relate back to a time days or weeks before the trustee is appointed. Accordingly, some customers may deal with the debtor after the filing date but prior to the appointment of a trustee and thus have claims which arise after the time at which all customers' claims are fixed. Although SIPC has advised us that it has been paying such claims, SIPC would prefer to see the matter clarified.

Proposed Section 6(c) (H-26) provides that if the trustee finds that the customer dealt with the debtor in good faith and prior to the appointment of the trustee, the date on which such action was taken will be deemed to be the filing date for that customer's claim and the customer will be protected. Proposed Section 9(a)(4) (H-42) provides, however, that SIPC is not required to make advances to protect such a customer.

While we understand SIPC's desire to assure that fraudulent claims are not paid, we believe the burden of screening out such claims should be placed on the trustee, subject to the supervision of the court. If the trustee makes a finding of good faith, the claimant should be elevated to the status of all other customers and should be entitled to receive full protection. It would be most inequitable to permit SIPC to veto the court-approved decisions of the trustee in this regard. Accordingly, the Commission strongly recommends, as we did in 1975, that subsection 9(a)(4) be deleted.

8. There is an overlap between proposed Section 6(e) (H-27) and proposed Section 8(c)(1) (H-34). Under Section 6(e), SIPC recoups from the general estate all funds advanced to pay or guarantee bank loans. This repayment has a first priority under the Bankruptcy Act. In addition, pursuant to Section 8(c)(1)(A) (H-35), SIPC has a first priority claim against customer property to recoup advances made to pay bank loans to the extent that such advances recovered securities that were apportioned to customer property. Thus SIPC recovers part of its advances twice. This can be corrected by inserting after "Section 9(c)(1)" in line 19 on H-27, "(to the extent such advances recovered securities which were apportioned to the general estate pursuant to section 6(d))".

9. Proposed Section 7(d)(4) (H-30) requires a trustee to submit to SIPC and others a statement of his investigation of certain matters. To assure that the report is comprehensive, we suggest that "matters referred to in paragraph (1)." be substituted for the enumeration of matters in lines 1-3 on H-31. In addition, we believe the trustee should be required to file a copy of the report with the Commission.

10. In order to reflect otherwise parallel language in the current Act, proposed Section 8(a)(1) (H-31) should be amended by inserting the phrase "at the same time" between "and" and "shall" in line 12 of H-31.

11. Proposed Section 8(c)(3) (H-36), which provides for the trustee's recovery under the Bankruptcy Act of certain transfers, appears to misplace the qualification that the transfer be void or voidable. As written, this condition serves to define what property, recovered from a transfer, should be allocated to customer property rather than what property may be recovered. This may be corrected by moving the phrase that begins in line 18 with "if" and continues through "Bankruptcy Act" in line 20 to the middle of line 17 after "customer property."

12. The saving clause in proposed Section 8(e)(1) (H-37, lines 22-25, and H-38, lines 1-3), which preserves Commission Rule S6d-1 until SIPC adopts rules under the amended Act, might usefully be moved out of what will become the SIPC Act and made a separate section of the legislation itself. This would avoid having in the Act a provision which quickly will become obsolete.

13. Proposed Section 8(e) (H-37) provides for closing out executory contracts of the debtor with other broker-dealers. The other broker-dealer is entitled to make a claim, to be satisfied out of SIPC funds, up to a maximum amount of $40,000, for each customer account with respect to which such broker-dealer sustains a loss in closing out contracts with the debtor.

If the claiming broker-dealer closes out an executory contract that was entered into on behalf of an associated person of that broker-dealer, it may not consider any loss on the transaction for purposes of its claim against SIPC because, under subsection (e)(4), an associated or controlling person of the broker-dealer is not deemed a customer. This should be contrasted with proposed Section 9(a)(6) (H-43) and the equivalent section of the current Act, Section 6(f)(1)(D) (p. 16 of the current Act). Those sections provide that where a broker has deposited funds or securities with the debtor on behalf of customers, 1/ each such customer is deemed to be a separate customer of the debtor. Under Section 9(a)(6) (and Section 6(f)(1)(D) of the current Act), associated and controlling persons of a broker-dealer other than the debtor are protected like all other customers.

An anomalous situation has thus been created in that where a broker-dealer has a claim for property left with a debtor on behalf of an associated or controlling person, the associated or controlling person is deemed a customer of the debtor, but where the broker-dealer suffers a loss closing transactions on behalf of an associated person, that person is not deemed a customer. We believe that associated persons of other broker-dealers should be treated as any other customer for purposes of both Sections 8(e)(4) and 9(a)(6) in the absence of any evidence of culpable behavior by those persons. Accordingly, we suggest that subparagraph (C) of proposed Section 8(e)(4) (H-40) be amended as follows (deletions in brackets):

> "(C) had a relationship of the kind specified in subsection 9(a)(5) with [either] the debtor [or the claiming broker or dealer]."

1/ Generally, this would occur where the claiming broker-dealer has an omnibus account with the debtor.

14. Section 8(e)(3) (H-39) prohibits both a clearing corporation which has established a procedure for the closing out of open contracts between an insolvent broker-dealer and its participants, and the participants themselves, from receiving SIPC funds in payment of any losses on such contracts. The provision was recommended in 1974 by the SIPC Task Force and, at that time, represented the consensus view of the industry members, SIPC and the Commission. There have been significant changes since then, however. Clearing agencies are now subject to registration under the Securities Exchange Act, and are self-regulatory organizations charged with a quasi-public responsibility. Moreover, the Commission is directed under the Securities Exchange Act to assure, among other things, that registered clearing agencies are able to facilitate the prompt and accurate clearance and settlement of securities transactions. In view of these developments, we believe the Act should provide the flexibility to extend SIPC protection to clearing agencies and their participants if that proves desirable. Accordingly, we propose the following revisions of Section 8(e)(3):

(i) In line 13 after "contracts" add ", except as SIPC may otherwise provide by rule."; and

(ii) In line 19 after "trustee." add "Rules adopted by SIPC under this paragraph shall provide that in no case may a registered agency or its participants, to the extent such participants' claims are or may be processed within the clearing agency, be entitled to receive funds advanced by SIPC in an amount greater, in the aggregate, than could be received by the participants if such participants proceeded individually under Sections 8(e)(1) and 8(e)(2)."

15. Proposed Section 10 (H-44) creates a direct payment procedure that SIPC may use in lieu of instituting a liquidation proceeding with respect to a member of SIPC. Various aspects of the proposed procedure parallel those of the liquidation provisions of the Act, but the new procedure applies to "members" rather than "debtors" and the payment of customer claims is effected by SIPC rather than a court-appointed trustee. The direct payment procedure is not self-contained in Section 10, however, and, to implement this alternative method of satisfying claims, SIPC must rely on other provisions, such as Sections 16(3) and 16(11) which define "customer" and "net equity" respectively, Section 8(d) setting forth requirements for the purchase of securities, and Section 9(a) limiting the protection available to each customer. Because those sections refer to the "debtor" and "trustee," they are, on their face, inapplicable to the direct payment procedure. In order to accommodate such provisions to direct payment

procedures, we recommend that: (i) the definition of debtor in Section 16(6) (H-58) be amended to include a member with respect to whom a direct payment procedure has been instituted under Section 10(b); (ii) a new Section 10(g) be added as follows:

> "For purposes of implementing this section, any reference to the 'trustee' in other applicable sections of the Act, including but not limited to sections 7(b)(1), 8(d), 8(f), 9(a), 16(3) and 16(11), shall be deemed a reference to SIPC and any reference to the date of publication of notice under section 8(a) shall be deemed a reference to the publication of notice under this section.";

(iii) the parenthetical material on H-46, lines 20-23 be conformed by placing a period and closing parenthesis after "section 9(a)" in line 21 and deleting the rest of the phrase; and (iv) Section 14(c)(2) (H-54) be deleted and Section 14(c)(1) (H-53) be renumbered Section 14(c).

16. Proposed Section 10(b) (H-45) requires customer claims in a direct payment procedure to be "filed" as well as "received" within a six month period in order to be entitled to protection. Section 8 on liquidations requires only that the claim be "received." We recommend deletion of the words "filed and" from line 10 on H-46.

17. The bill at H-49 proposes to repeal Section 7(d), page 18 of the current Act. Section 7(d) amends Section 15(c)(3) of the Securities Exchange Act of 1934, which empowers the Commission to establish financial responsibility standards for broker-dealers. The proposed deletion would appear to have the effect of repealing the amendments to Section 15(c)(3) enacted in 1970. Confusion may have arisen because of the addition of a definition of the term "financial responsibility rules" (H-64). Both the definition and Section 7(d) of the current Act should be retained.

18. Proposed Section 13(a) (H-49) designates the collection agents to whom SIPC members remit assessments. The proposed section is ambiguous with respect to the role of a registered

clearing agency which, under the Securities Exchange Act is a self-regulatory organization. Proposed Section 13(a) states that the self-regulatory organization that is the examining authority for a SIPC member shall act as the member's collection agent unless, where the member is a member of or participant in more than one self-regulatory organizations, SIPC designates another self-regulatory organization.

When a registered clearing agency is the only self-regulatory organization in which a member is a participant, it often will not be the examining authority because Section 13(c)(1) (H-50) provides in that case that the Commission may designate itself as examining authority. We believe clearing agencies should act as collection agents if SIPC chooses to so designate them. Accordingly, we propose the following sentence be inserted at H-50, line 7 after the period:

> "If the only self-regulatory organization of which a member of SIPC is a member or in which it is a participant is a registered clearing agency that is not the examining authority for the member, SIPC may, nevertheless, designate such clearing agency as collection agent for the member or may require that payments be made directly to SIPC."

19. Proposed Section 13(c) (H-50) discusses the allocation of inspection responsibility over SIPC members for compliance with applicable financial responsibility rules. The Securities Acts Amendments of 1975 amended Section 9(c) of the SIPC Act (predecessor of proposed Section 13(c)) to authorize the Commission, rather than SIPC, pursuant to Section 17(d) of the 1934 Act, to designate the examining authority when a member of SIPC is a member of more than one self-regulatory organization. In transposing the language, H.R. 8331 deleted the reference in current Section 9(c) to Section 17(d) of the Securities Exchange Act. The phrase ",pursuant to Section 17(d) of the 1934 Act," should be added in H-51, line 4, after "Commission."

20. If Section 10(a) of the current Act is amended by replacing "he" with "it" (H-51), the Subcommittee should assure that conforming changes, if needed, are made elsewhere in the Act.

21. H.R. 8331 revises Section 10(c), redesignated as Section 14(c) (H-52), which enumerates certain criminal acts. We have redrafted and renumbered the proposed language. In addition, we have prepared two new sections. Subparagraphs (1)(A) and (1)(B) of the proposed revision add general fraud language to cover violations not included in the enumeration of specific activities in subparagraphs (1)(C) and (2). The latter have been revised to make them clearer and to impose what we believe to be an appropriate standard of accountability throughout the section. Our suggested version of Section 14(c) 2/ is as follows:

> "(c) Concealment of Assets; False Statements or Claims. --
>
> "(1) Specific Prohibited Acts -- Any person who, directly or indirectly, in connection with or in contemplation of any liquidation proceeding or direct payment procedure --
>
> (A) employs any device, scheme, or artifice to defraud; or
>
> (B) engages in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person; or
>
> (C) fraudulently or with intent to defeat this Act --
>
> (i) conceals or transfers any property belonging to the estate of a debtor; or
>
> (ii) makes a false statement or account; or
>
> (iii) presents or uses any false claim for proof against the estate of a debtor; or

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2/ You will note in paragraph 15(iv) above that we recommend deletion of Section 14(c)(2).

(iv) receives any material amount of property from a debtor; or

(v) gives, offers, receives, transfers or obtains any money or property, remuneration, compensation, reward, advantage, other consideration, or promise thereof, for acting or forebearing to act; or

(vi) conceals, destroys, mutilates, falsifies, makes a false entry in, or otherwise falsifies any document affecting or relating to the property or affairs of a debtor; or

(vii) withholds from any person entitled to its possession, any document affecting or relating to the property or affairs of a debtor --

shall be fined not more than $5,000 or imprisoned for not more than five years, or both.

"(2) Any person who, directly or indirectly steals, embezzles, or fraudulently, or with intent to defeat this Act, abstracts, or converts to his own use or to the use of another, any of the moneys, securities, or other assets of SIPC, or otherwise defrauds or attempts to defraud SIPC or a trustee by any means, shall be fined not more than $5,000 or imprisoned not more than five years, or both."

22. Proposed Section 16(3) (H-56), amending the definition of "customer," would eliminate clause (VI) of Section 6(c)(2)(A)(ii) of the current Act which could be construed as providing SIPC protection to persons who lend their securities to brokers. Although the amended provision does not address stock loans, SIPC has indicated that lenders would not be protected if they receive either collateral or consideration for their loans, but would be protected if they do not receive collateral or consideration.

It is the Commission's understanding that, under current industry practice, lending of securities is primarily an institutional business. Institutions lend securities in order to add leverage to their portfolios, and they recognize and are capable of accepting the associated business risk. On the other hand, brokers might borrow from individual investors who would not realize that by entering into such arrangements they would lose SIPC coverage.

The Commission does not object to the change, but we believe that what SIPC proposes to do should be made clear in the legislative history. Moreover, if the proposed change is made, the Commission will consider providing, by rule, additional protections for retail customers who lend securities to their brokers.

23. The exclusion of subordinated lenders of securities from the proposed definition of "customer" (Section 16(3), H-56) does not prevent subordinated lenders from seeking rescission but rather merely denies to them customer status. If some ground for the lender to seek rescission exists, the exclusion provision does not remove or modify that ground. The proposed "notwithstanding" clause (H-57, line 1) however, implies that the right of rescission is affected by the exclusion of the lender from customer status in that it refers to grounds that "might have existed." Since the exclusion does not derogate a subordinated lender's right to seek rescission, we recommend that the provision be clarified by substituting "exists" for "might have existed" in line 2.

24. We question whether, in the definition of "customer property" (Section 16(5), H-57), the explicit reference in paragraph (B) to Rule 15c3-3 under the 1934 Act and its reserve requirement formula is useful. The Subcommittee may wish to consider the following more general language as a substitute for paragraph (B) (H-58):

> "resources provided through the use or realization of customers' debit cash balance and other customer-related debit items as defined by the Commission by rule;"

25. In Section 16(8)(C) (H-59) there is an unintended ambiguity in the definition of "filing date" in relation to the direct payment procedure. We believe it would be better phrased, "(C) if the debtor is the subject of a direct payment procedure, or has been the subject of a direct payment procedure discontinued by SIPC pursuant to section 10(f),. . . ."

26. Various provisions of the current Act have spent their force. The Subcommittee may wish to consider whether such provisions need to remain in the Act or whether they should be repealed.