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SUMMARY OF PRINCIPAL PROVISIONS OF  
SECURITIES ACTS AMENDMENTS  
OF 1975

S. 249

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SUMMARY OF THE PRINCIPAL PROVISIONS OF THE SECURITIES ACTS  
AMENDMENTS OF 1975

S. 249, the Securities Acts Amendments of 1975, consolidates five bills—S. 470, S. 2058, S. 2519, S. 2474, and S. 2234—considered during the 93d Congress. The first four of these bills passed the Senate, and extensive hearings were held on the fifth.

The genesis of this legislation is the Securities Industry Study Report of the Subcommittee on Securities (S. Doc. No. 93-13, 93d Cong., 1st sess. 1973). This Report grew out of an extensive 18-month study. Its major recommendations, embodied in S. 249, point to a fundamental reform of the economic and regulatory structure of the securities markets and the securities industry.

I. COMMISSION RATES

The Securities and Exchange Commission (the "SEC" or the "Commission") has clear authority under existing provisions of the Securities Exchange Act of 1934 (the "Exchange Act") to control the level and extent of fixed rates of commission imposed on transactions effected on a national securities exchange. The SEC also has clear authority to abolish such fixed rates entirely. The Securities Acts Amendments of 1975 (the "bill") would not affect this authority. Because the SEC is proceeding in a deliberate and responsible manner to phase out fixed rates, further legislation in this area appears to be unnecessary. As the Banking Committee stated in its report on S. 470 during the last Congress:

Although . . . fully competitive rates are necessary and appropriate for the long term health of the securities industry, the development of a true central market system, and the protection and fair treatment of investors, there are serious difficulties with any attempt by the Congress to set the precise date on which fixed rates are to be eliminated.

*A. Determination of the Reasonableness of Fixed Rates*

The bill would, however, make one important change in the nature of the SEC's responsibility with respect to fixed rates of commissions insofar as such rates are permitted. As early as 1963, the SEC's Special Study of the Securities Markets stated:

The general standard of reasonableness [governing commission rates in the Exchange Act] is the kind of general standard that needs to be given specific content in the course of administration: yet after nearly 30 years there has been no comprehensive and consistent public articulation, on the part of the Exchange or the Commission, of the principles or criteria to be applied in interpreting the standard.

The Securities Industry Study Report of the Subcommittee on Securities (the "Report") reached the same conclusion ten years later: "... the setting of reasonable fixed rates in the securities industry still proceeds without an adequate rationale or sufficient benchmarks. . . ."

The absence of articulated standards for ratemaking in the securities industry would be corrected by requiring that if fixed rates are permitted, the SEC must (1) find that the rates are "reasonable in relation to the costs of providing the service for which such charge is made" and (2) publish "the standard employed in adjudging reasonableness." (Sec. 19(b)(2))<sup>1</sup> The SEC would be given explicit authority over the accounting practices of brokers and dealers to assure a proper data base for any ratemaking proceeding. (Sec. 17(e))

*B. "Failsafe" Provisions with Respect to Fully Competitive Commission Rates*

The controversy over the desirability and timing of the elimination of fixed commission rates has led to a general belief that the SEC should have flexible authority to deal effectively with any untoward consequences of a fully competitive rate environment. To assure the SEC has such authority, the bill would grant the SEC, in addition to broad general powers related to the protection of investors and the maintenance of fair and orderly markets, three powers designed specifically to deal with problems which may be caused by fully competitive commission rates.

First, the bill would authorize the SEC to require any broker or dealer who effects transactions on an exchange "on a regular basis" but is not a member of that exchange, "to comply with respect to such transactions with such rules of the exchange as the Commission may specify." The exchange would be authorized to enforce compliance with such rules by the broker or dealer and, with respect to transactions on the exchange, the broker or dealer would be deemed to be a "member" of the exchange for purposes of various procedural and regulatory provisions of the Exchange Act. (Secs. 6(f) and 3(a)(3))

Second, the bill would direct the Commission to take all appropriate action to deal with any serious disruption in the operation of the markets for listed securities caused by trading in the third market after the advent of fully competitive rates. The SEC would have broad rule-making authority in this regard, e.g., it could impose affirmative market making obligations on third market dealers or prohibit retail securities firms from dealing as principal with public customers in listed securities. (Sec. 15(c)(5)) In addition, the SEC would be authorized, upon carefully prescribed factual findings, subject to judicial review on a standard of substantial evidence, to prohibit all trading of listed securities in the third market. (Secs. 11A(c)(4) and 25(b))

Third, subject to the finding of reasonableness discussed above, the SEC could at any time permit the exchanges to reestablish fixed rates if it finds that fixed rates are "necessary to accomplish the purposes of [the Exchange Act]." (Sec. 19(b)(2))

<sup>1</sup> Section references, unless otherwise indicated, are to sections of the Securities Exchange Act of 1934 as amended by the bill.

II. INSTITUTIONAL MEMBERSHIP

Institutional membership on stock exchanges (i.e., the performance of both investment management and brokerage services for the same institutional account by the same exchange member) has caused (1) impediments to fair competition between investment managers, (2) conflicts of interest, and (3) distortions in the efficient allocation of securities trading. The bill would resolve these problems by prohibiting stock exchange members from effecting any transaction on the exchange for any account in which the member or an associated person has a financial interest or with respect to which the member or an associated person exercises investment discretion. (Sec. 11(a)(1))

The bill would exempt from this prohibition certain types of transactions by exchange members which contribute to the fairness and orderliness of exchange markets or which have not given rise to serious problems. For example, exemptions would be provided for transactions by market makers, including specialists and block positioners; stabilizing transactions permitted under section 10(b) of the Act; bona fide arbitrage transactions; transactions made with the approval of floor officials; and transactions to offset transactions made in error. Transactions for a member's own account and transactions for the account of a natural person or trust created by a natural person for himself or another natural person would also be exempted. In addition, the SEC would have the authority to exempt any other transaction which is consistent with the purposes of the subsection. (Sec. 11(a)(1)(A)-(I))

All exchange transactions which come within the broad prohibition but which are specifically exempted could be regulated or prohibited by the SEC as it deems necessary or appropriate in the public interest or for the protection of investors. (Sec. 11(a)(2)(A)) The Commission would be authorized to extend the broad prohibition against the combination of money management and brokerage to the over-the-counter market in order to prevent any disincentive to belong to or trade on an exchange or to protect investors. (Sec. 11(a)(2)(B))

An exchange member would be deemed to exercise "investment discretion" with respect to an account if he has legal responsibility for the investment of the account's assets or in fact makes the day-to-day investment decisions for the account. The later *de facto* test is intended to reduce the danger of evasion of the bill's prohibition against any combination of brokerage services and institutional money management through artificially structured arrangements. The Commission would also have the authority to include within the definition of "investment discretion" such other "influence with respect to the purchase and sale of securities" as it determines should be subject to regulation. (Sec. 3(a)(35))

The bill's prohibition against an exchange member executing transactions for an account in which it or an associated person has an interest or an account with respect to which it or an associated person exercises investment discretion would not become effective until all fixed rates of commission had been eliminated. (Sec. 11(a)(3))

During the period prior to the elimination of fixed rates, neither the SEC nor any exchange would have the authority to promulgate any rule or take any other action to prohibit transactions by an exchange member for the account of any associated person which is not a natural person or any account with respect to which such member or an associated person exercises investment discretion from off the floor of the exchange. (Sec. 11(a)(4)) Thus, the SEC's Rule 19b-2 would have to be withdrawn. The SEC would, however, retain its full powers under the Exchange Act to regulate floor trading and members' trading for their own account.

### III. FIDUCIARY STANDARDS

The bill would resolve the uncertainty about the legality of a fiduciary paying higher commissions out of a beneficiary's funds to a broker who provides the fiduciary with valuable research services. (Sec. 24 of the bill) This would be done by amending the Investment Company Act of 1940 and the Investment Advisers Act of 1940 to make clear that in a competitive rate environment, a fiduciary registered with the SEC and subject to the SEC's regulation does not act in breach of his fiduciary obligation solely by reason of causing or inducing his fund or client to pay a broker a commission for effecting a transaction in excess of the commission being charged by other brokers for effecting similar transactions.

Under the amended statutes, the payment of higher commission charges for research services would be authorized, however, only if:

- A. The investment adviser determines, in good faith, that the research services provided by the broker to the fund or client justified the higher commission payment;
- B. The investment company or investment adviser discloses to the fund security-holders or the advisers' client, pursuant to rules of the SEC, the circumstances in which and the research services for which the investment company or adviser pays higher fees; and
- C. The broker to whom these higher commissions are paid is not affiliated with the investment company or investment adviser. Subject to these provisions, money managers would still have a fiduciary duty to obtain best execution for the securities transactions of their funds and clients.

### IV. SELF-REGULATION AND SEC OVERSIGHT

The securities industry's unique system of self-regulation has shown great strength in some areas and, in general, has served the industry well. It has also, however, displayed serious deficiencies and has not operated as effectively or fairly as it should.

The bill contains a number of provisions which would clarify the scope of the self-regulatory responsibilities of national securities exchanges and registered securities associations (which are defined in section 3(a)(26) as "self-regulatory organizations") and the manner in which they are to exercise those responsibilities. The bill would also clarify and strengthen the SEC's oversight role with respect to the self-regulatory organizations.

### A. Concept of Membership

The concept of "membership"—i.e., voluntary association with an industry organization—is fundamental to the self-regulatory system established by the Exchange Act. However, because of certain changes in the operation of the markets, a change in the definition of "member" appears desirable. Presently, "member" is defined only for exchanges and includes any person permitted (1) to effect transactions on an exchange without the use of another person acting as broker or (2) to use the facilities of the exchange without the payment of a commission or with the payment of a commission less than that charged the general public. When fixed commission rates are eliminated the concept of commission "charged the general public" will become obsolete. Furthermore, in a national market system institutional investors may well be permitted to effect transactions on exchanges without the use of another person acting as broker. Without an amendment of this definition, therefore, such investors would automatically be deemed members of the exchange on which such trades are effected.

Section 3(a)(3) as amended by the bill would redefine "member" to mean a person who has agreed to be regulated by a national securities exchange or registered securities association and with respect to whom such exchange or association has undertaken to enforce compliance with its rules, the Exchange Act, and the rules and regulations thereunder. An exchange's or association's undertaking would not, however, be discretionary with respect to persons qualified for membership. In other words, if a person meets the requirements for membership he must be admitted. (Secs. 6(b)(2) and 15A(b)(3)) And with respect to a person admitted, i.e., a member, an exchange or association must enforce compliance with its rules, the Exchange Act, and the rules and regulations thereunder. (Sec. 19(g))

### B. Procedural Standards for Self-Regulatory Action

The self-regulatory organizations exercise governmental power in three ways which may adversely affect the interests of particular persons: (1) by imposing a disciplinary sanction, broadly defined, on a member or person associated with a member, (2) by denying membership to an applicant, and (3) by requiring members to cease doing business entirely or in specified ways with a particular non-member or with respect to a particular security.

The bill would establish the following minimum procedural standards for such self-regulatory action:

(1) The rules of a self-regulatory organization must provide a fair procedure for disciplinary action against any member or person associated with a member, the denial of membership, the barring of any person from being associated with a member, and the prohibition or limitation of any person with respect to requested access to services offered by the organization or any member thereof. (Secs. 6(a)(7) and 15A(b)(8))

(2) Notice of any final action by a self-regulatory organization adversely affecting a member or non-member must be filed with the Commission and made available for public inspection. (Secs. 19(d) and 24)

(3) The Commission, on its own motion or pursuant to the petition of any aggrieved person, may review any action by a self-

self-regulatory organizations to take specified actions. And, as the Report demonstrated, there are several problems with the SEC's existing indirect regulatory powers.

First, the SEC has divergent authority with respect to a registered securities association's rules on the one hand and an exchange's rules on the other. Under the bill, the SEC would have uniform authority to "abrogate, add to, or delete from" any self-regulatory organization's rules. (Sec. 19(c))

Second, there has been a continuing controversy as to the precise scope of the SEC's power to amend the rules of a self-regulatory organization. The bill would give the SEC clear authority to amend any self-regulatory organization's rules in any respect consistent with the objectives of the Exchange Act. (Sec. 19(c))

Third, there is also a controversy over the procedures that the SEC must follow in order to force a change in the rules of a self-regulatory organization. In recognition of the quasi-legislative, policy-making nature of an SEC determination to require such a change, section 19(c) would provide that the Commission's action shall be by "rule". Accordingly, the basic procedures the Commission would be required to follow are specified in the Administrative Procedure Act (5 U.S.C. § 553) for rulemaking not on the record. The bill would, however, also require the SEC to (1) provide all interested persons an opportunity to present their views in person as well as in writing; (2) keep a transcript of all oral presentations; and (3) publish a statement of its reasons for taking the action it did, including an identification of the facts it has relied upon in reaching its conclusion. (Sec. 19(c))

In order to avoid any doubt as to the SEC's authority in areas where its direct authority overlaps its indirect authority, section 19(c)(4) would make clear that where the Commission has direct authority, it would not be required to proceed under section 19(c) or to follow the procedures specified in that section. In such cases, the SEC could rely on its direct authority and follow the usual Administrative Procedure Act requirements for notice and comment rule-making.

#### *F. Coordination of Self-Regulatory Responsibilities*

The Report concluded that the present allocation of self-regulatory responsibilities has two significant defects:

First, the activities and records of many firms are subject to inspection and surveillance by more than one self-regulatory organization.

Second, the standards of the different self-regulatory organizations differ both in substance and in enforcement.

The bill would correct these defects by providing the SEC with authority to establish an explicit allocation of self-regulatory responsibilities and to eliminate unequal regulation in the securities industry. Amended section 17(d) of the Exchange Act and section 23 of the bill would transfer the present authority of the Securities Investor Protection Corporation to allocate responsibility for the enforcement of financial responsibility rules to the SEC and vest the SEC with the additional authority to rationalize the allocation of all other self-regulatory responsibilities. Finally, section 11A(a)(2) would direct the SEC to assure that all securities firms are subject to each regulation as defined in Sec. 32(a)(36).

#### *G. SEC Enforcement Powers*

The Commission has oversight responsibility with respect to the self-regulatory organizations to insure that they exercise their delegated governmental power effectively to meet regulatory needs in the public interest and that they do not exercise that delegated power in a manner inimical to the public interest or unfair to private interests.

To enhance the SEC's oversight powers and provide it with greater regulatory flexibility, the bill would significantly increase the regulatory options available to the SEC to deal with perceived self-regulatory short comings.

First, section 19(h)(1) would authorize the SEC, by order, upon appropriate findings, to censure or place limitations on the activities, functions, and operations of a self-regulatory organization. These powers would be in addition to suspension and deregistration.

Second, section 19(h)(1) would also expand the grounds on which the SEC could sanction a self-regulatory organization. For example, the SEC would be able to take appropriate action against a self-regulatory organization upon a finding that it had failed to enforce its own rules, the Exchange Act, or the rules thereunder.

Third, section 19(h)(4) would authorize the SEC to censure or remove from office any officer or director of a self-regulatory organization who had willfully failed to enforce compliance with the Exchange Act, the rules thereunder, or the organization's own rules.

Fourth, sections 21(e) and (f) would empower the SEC to apply to a Federal court for an order to (1) enjoin the violation of the rules of a self-regulatory organization; (2) command a member of a self-regulatory organization to comply with the rules of such organization, or (3) command a self-regulatory organization to enforce compliance by its members with the Exchange Act, the rules thereunder, and the organization's own rules.

#### *H. Judicial Review*

The bill would substantially revise Section 25 of the Exchange Act concerning judicial review of SEC action. The bill would (1) simplify and clarify the provisions relating to the review of Commission orders and (2) establish a statutory review procedure for certain SEC rules.

The changes with respect to review of SEC orders would codify and clarify existing law but would not alter in any fundamental respect the availability of court review of orders or the manner in which such review is exercised.

The bill's major innovation in the area of judicial review relates to SEC rule-making. At the present time there is no provision for statutory review of Commission rules. Preenforcement review of rules, to the extent it is available, is pursuant to the Administrative Procedure Act (5 U.S.C. § 702) and is thus in the District Court. The bill would establish a preenforcement review procedure in the Court of Appeals for any SEC rule promulgated under sections 6, 11, 11A, 15(c)(5) or (6), 15A, 17, 17A or 19 of the Exchange Act, i.e., any provision relating to the operation or regulation of the national market system or national system for the clearance and settlement of securities transactions, or the SEC's oversight of the self-regulatory organizations.

## V. NATIONAL MARKET SYSTEM FOR SECURITIES

In the Report, the Subcommittee on Securities emphasized the importance of empowering the SEC to shape the development of and maintain adequate regulatory control over an integrated, national market system. Section 2 of the bill sets the pattern for the later substantive provisions implementing this recommendation by amending the Exchange Act to include among its purposes to "remove impediments to and perfect the mechanism of a national market system in securities."

### A. Communications Among and Dissemination of Information About Securities Markets

Communications systems for the automated dissemination of transaction and quotation information with respect to securities will form the heart of the national market system. The bill would expand the SEC's authority and responsibility to regulate persons operating and administering such systems by adding Section 11A to the Exchange Act. This new section, entitled, "National Market System for Securities; Securities Information Processors", would bring under the SEC's jurisdiction all organizations engaged in the business of collecting, processing, or publishing information relating to quotations for or transactions in securities.

Sec. 11A(b) would give the SEC broad authority to regulate and oversee the activities of registered securities information processors (as defined in section 3(a)(22)) and national securities exchanges and Registered Securities Associations when they are performing processing and communication functions related to the securities markets. For example, the SEC would be directed to assure that all brokers and dealers and vendors of market information have access on reasonable terms to all services of any registered securities communication system. (Sec. 11A(c)(3)(A)) The SEC would be authorized to review any exclusionary action taken by a registered securities information processor. (Sec. 11A(b)(5)) In addition, the SEC would be authorized to promulgate rules to facilitate the prompt, accurate, and reliable collection, processing, distribution, and publication of information with respect to quotations and transactions, i.e., to develop and oversee a composite tape and composite quotation system. (Sec. 11A(c)(1))

Other powers conferred upon the Commission would include the authority to promulgate rules to prevent the publication of fraudulent or manipulative information with respect to quotations and transactions (Sec. 11A(c)(1)(A)); to specify the method and manner in which information with respect to quotations and transactions is published and the form and content of such information (Sec. 11A(c)(1)(C)); to assure the prices charged by any central processing authority are reasonable (Sec. 11A(c)(1)(D)); to allocate among persons furnishing information to a registered securities information processor the costs associated with collecting, processing, distributing, and publishing such information (Sec. 11A(3)(C)); and to require disclosure of transactions which take place in the fourth market. (Sec. 11A(c)(2))

### B. Elimination of Unnecessary Regulatory Restrictions

As a result of its Securities Industry Study, the Subcommittee on Securities concluded that the development of a national market sys-

tem will depend in large measure on the removal of unnecessary regulatory impediments to competition among markets and market participants. However, rather than recommend that the Exchange Act be amended to require the elimination of particular enumerated impediments, the Subcommittee concluded that the better approach would be to charge the SEC with the responsibility to eliminate all present and future competitive restraints which, in its view, cannot be justified by the purposes of the Exchange Act.

Following this approach, the bill would impose on the SEC an affirmative obligation to eliminate all present and future burdens on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act. Thus, the SEC would be required to review the rules of all self-regulatory organizations to assure that they do not impose any such burden on competition. (Sec. 6(b)(8) and 15A(b)(9)) A self-regulatory organization could not amend its rules unless the SEC found that the amendment would not impose an unnecessary competitive burden. (Sec. 19(b)) Actions by a self-regulatory organization which have an adverse impact on an individual or a firm, e.g., disciplinary sanctions levied against a member or denial of membership to a broker-dealer, would be subject to review by the SEC and reversal if they were found to impose an unnecessary burden on competition. (Secs. 19(e) and 19(f)) The SEC would also be empowered to abrogate, add to, or delete from the rules of a self-regulatory organization if it deems such action necessary or appropriate to remove burdens on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act. (Sec. 19(c))

Further, the bill would require the SEC to evaluate its own regulatory proposals in light of the fundamental national economic policy of furthering competition and would prohibit the SEC from promulgating any rule which would impose a burden on competition not necessary or appropriate to achieve the purposes of the Exchange Act. (Sec. 23(a)(2))

### C. Regulation of Market Makers

The Subcommittee on Securities concluded in its Report that market making capacities must be strengthened to absorb the large trading imbalances created by institutional transactions, and it expressed its belief that this could be best achieved by encouraging vigorous competition among market makers. The bill would advance this position by empowering and directing the SEC to remove present restrictions on communication among market makers and to open new opportunities for competition. (Sec. 11A(c))

Following the Subcommittee's recommendation to establish adequate regulatory authority "to back up the competitive pressure to make tight and continuous markets", the bill would add a new section to the Exchange Act giving the SEC authority over the activities of all market makers. (Sec. 15(c)(5)) In addition, the bill would direct the SEC to assure that market makers are subject to equal regulation. (Sec. 11A(a)(2))

### D. Auction Trading Principles

To guarantee that public investors enjoy the benefits of "auction" trading in connection with orders for securities with suitable characteristics, the bill would give the SEC the authority to prescribe rules

requiring all broker-dealers trading for their own account in such securities to yield in the execution of their transactions to public orders. Sections 11(a)(2) and 11(b) would provide the SEC with this authority over members of exchanges. Section 15(c)(5) would provide the SEC with this authority with respect to dealers operating in the third market. The SEC would also be given similar regulatory control over transactions effected by persons with access to exchange markets on terms comparable to those enjoyed by members. (Sec. 6(e))

In order to assure priority for public orders, a mechanism must be established by which specialists and other market makers can be made aware of all such orders within the national market system. The bill would, accordingly, vest the SEC with the authority to require all dealers, whether operating from on or off an exchange floor, to disclose to such persons as the SEC indicates the limited price orders they hold or which are in their "book". (Secs. 11(b) and 15(c)(5))

#### *E. Auction Trading of Unlisted Securities*

The Subcommittee on Securities concluded in its Report that once communication and competition among market makers are a reality, stocks should attract the type of market (i.e., the balance of "auction" and "dealer" qualities) warranted by their trading characteristics. This means that corporate management should not be able to limit the markets in which investors can trade the corporation's securities by choosing, for example, not to "list" those securities on an exchange.

The bill follows the Report's recommendation and would give the SEC authority to define the securities suitable for trading in the national market system (Sec. 11A(a)(3)) and to permit an exchange to commence trading in securities which are not "listed" on any exchange. (Sec. 12(f)(3)) Standards would be established to guide the Commission in considering applications for the extension of so-called "unlisted trading privileges", including the public trading activity in the security, the impact of the extension on the existing markets for the security and on competition, and the progress that has been made toward the development of a national market system. (Sec. 12(f)(2))

#### *F. Reports to the Congress*

In order that the Congress and the public may be kept informed of the progress toward a national market system, the bill would require the SEC to include in its annual reports information with respect to the development of such a system, the activities, capabilities, and plans of the self-regulatory organizations relating thereto, and the effect the absence of fixed commission rates may be having on the development of such a system. (Sec. 23(b)(3) and (8))

### VI. NATIONAL SYSTEM FOR CLEARANCE AND SETTLEMENT OF SECURITIES TRANSACTIONS

Broadly stated, the bill would create a system of regulation and decision-making extending to all facets of securities handling related to securities transactions within the United States. The bill would vest the SEC with authority and responsibility to correct securities handling problems and to develop a national system for the prompt and accurate clearance and settlement of securities transactions. In

some areas the authority conferred upon the Commission would be exclusive. In other areas, the Commission would share responsibility with the bank regulatory agencies.

#### *A. Clearing Agencies*

The bill would require "clearing agencies", as defined in section 3(a)(23), to register with and report to the Commission. (Secs. 17A(b) and 17(a)(1)) The Commission would be empowered to review the rules of such clearing agencies (Sec. 19(b)) and to adopt necessary and appropriate rules for their regulation and the regulation of persons doing business with them. (Sec. 17A(d)(1)) Registered clearing agencies would be "self-regulatory organizations" (Sec. 3(a)(26)) and therefore subject to those provisions of the bill applicable to self-regulatory organizations discussed above.

Overall policy responsibility for the development and coordination of the securities handling system would be delegated to the SEC. With respect to clearing agencies which are banks, however, enforcement and inspection responsibilities would be delegated to the bank regulatory agencies. (Secs. 17(a)(2) and 17A(d)(2)) In addition, the bill would expressly recognize the responsibility of the banking agencies to assure the safeguarding of funds and securities held by bank clearing agencies. Thus, a bank could not be registered as a clearing agency if the appropriate banking agency finds that it cannot adequately safeguard funds and securities within its custody or control or for which it is responsible. (Sec. 19(a)(2)) Similarly, a bank clearing agency would not be permitted to change its rules in a way the appropriate bank regulatory agency finds to be contrary to appropriate standards for the safeguarding of securities and funds. (Sec. 19(b)(4)) A bank clearing agency would also be prohibited from operating in contravention of rules the banking agency promulgates as necessary or appropriate for the adequate safeguarding of funds and securities.

The Commission would have the right to review the operations of bank clearing agencies if such review were necessary to fulfill its rule-making or other policy-making responsibilities. (Sec. 17(b)) This authority would be circumscribed to assure that any such Commission review could occur only after consultation with the appropriate bank regulatory agency and only with respect to matters which are germane to policy proposals then before the Commission.

Several provisions of the bill are designed to assure cooperation among and avoid duplicate regulation by the several agencies which regulate bank clearing agencies. The Commission, and the bank regulatory agencies would be required to furnish one another copies of reports concerning bank clearing agencies and to notify each other of actions taken with regard to bank clearing agencies. (Secs. 17(c) and 17A(d)(4)) The regulatory agencies charged with regulation and inspection of bank clearing agencies would be required to consult with and request the views of each other before issuing a proposed rule concerning such clearing agencies or adopting such a rule. (Sec. 17A(d)(4)(A)(ii)) Nothing contained in the bill would impair the authority of any state banking authority or of any other state or Federal regulatory authority which has jurisdiction over a person registered



as a clearing agency to make or enforce rules governing such a person if such rules are not inconsistent with the Exchange Act or any rules prescribed thereunder. (Sec. 17(d)(5))

#### B. Transfer Agents

The bill would require registration and reporting by transfer agents. In cases where the transfer agent is a bank, registration would be with the appropriate bank regulatory agency, and in the case of other transfer agents, registration would be with the Commission. (Sec. 17A(c)) The Commission would have broad rule-making authority over all aspects of a transfer agent's activities. (Sec. 17A(d)(1)(A)) This would include such matters as: minimum standards of performance, the prompt and accurate processing of securities transactions, and operational compatibility of and cooperation by transfer agents with other facilities and participants in the securities handling process. The bank regulatory agencies would have rule-making authority with respect to the safeguarding of securities and funds by bank transfer agents. (Sec. 17A(d)(1)(B))

Inspection and enforcement of rules and regulations applicable to bank transfer agents would be the primary responsibility of the appropriate banking agency. (Secs. 17(a)(3), 17(b), and 17A(d)(4)(A)(iii)) However, to assist the Commission in discharging its policy-making functions in an informed manner, the bill would give the SEC authority to review the operation of bank transfer agents. (Sec. 17(b)) Such Commission review could occur only after consultation with the appropriate bank regulatory agency and only with respect to matters which are germane to policy proposals then before the Commission. Finally, the bill contains provisions similar to those applicable to bank clearing agencies designed to provide, to the maximum extent practicable, cooperation and coordination among the various agencies supervising bank transfer agents. (Sec. 17A(d)(4))

#### C. Elimination of Stock Certificate

The bill would direct the Commission to take such steps as are within its power to bring about, by the end of 1976, the elimination of the negotiable stock certificate as a means of settlement among brokers and dealers of transactions consummated on national securities exchanges or by means of the mails or other instrumentalities of interstate commerce. (Sec. 17A(e)) This provision would not preclude individual shareholders from asking for and receiving certificates as proof of ownership of their shares. The Commission would also be required to report annually to Congress on its progress in eliminating the certificate as a means of settlement and its recommendations, if any, for further legislation to eliminate the certificate. (Sec. 23(b)(4))

#### D. "Street Name" Registration of Securities

The bill would direct the Commission to study the practice of registering securities in "street name" to determine (1) whether such registration is consistent with the policies of the Exchange Act, and (2) whether steps can be taken to facilitate communications between corporations and their shareholders while at the same time retaining the benefits of "street name" registration. (Sec. 12(m)) The Com-

mission would be directed to report its preliminary findings to the Congress within six months of the bill's enactment and its final recommendations within one year.

#### E. State Taxes on Securities Transactions

The bill would prohibit the imposition of state taxes on securities or upon the transfer of securities merely because the facilities of a clearing agency are physically located in the taxing state. This provision is designed to facilitate the development of a national system for handling securities transactions while at the same time preserving state taxing powers with respect to transactions for which the taxing state has a traditional jurisdictional basis. (Sec. 28(c))

### VII. MUNICIPAL SECURITIES

The bill would extend the basic coverage of the Exchange Act to securities firms and banks which underwrite and trade securities issued by states and municipalities. All such firms would be classified as "municipal securities dealers," and as such they would be required to register with the Commission and comply with rules concerning just and equitable principles of trade and other matters prescribed by a new self-regulatory organization called the Municipal Securities Rulemaking Board. Although the bill would establish a pervasive and coordinated scheme of federal regulation of the activities of municipal securities dealers, the issuers of municipal securities would continue to be exempt from the basic regulatory requirements of the federal securities laws. (Secs. 3(d) and 15B)

#### A. Registration of Municipal Securities Dealers

Brokers and dealers that buy, sell, or effect transactions in municipal securities and banks that buy and sell such securities as a part of a regular business other than in a fiduciary capacity would be required to register with the SEC as "municipal securities dealers." (Sec. 15B(a)(1)) If a bank engages in the business of trading municipal securities through a separately identifiable department or division, that department or division rather than the entire bank could register with the Commission. (Secs. 3(a)(30) and 15B(b)(2)(H)) Brokers and dealers already registered with the SEC by reason of their general securities business would not be required to re-register.

Registration of a securities firm or bank as a municipal securities dealer would be conditional upon specified filings and a determination by the SEC that the firm could comply with standards established by the Municipal Securities Rulemaking Board. (Sec. 15B(a)(2)) No person would be permitted to engage in the business of trading in municipal securities unless registered with the SEC, and the SEC would have the authority, in accordance with specified procedures, to revoke the registration of any person found to be in violation of the Exchange Act or any rule of the SEC or the Municipal Securities Rulemaking Board. (Sec. 15B(c)(2))

#### B. Municipal Securities Rulemaking Board

A self-regulatory body called the Municipal Securities Rulemaking Board (the "Board") would be established and delegated responsi-

bility to formulate rules regulating the activities of all municipal securities dealers. (Secs. 15B(b)(1) and (2)) Unlike the existing self-regulatory organizations, the Board would not be a membership organization, nor would it have any inspection or enforcement responsibilities. Its sole function would be to prescribe rules for the municipal securities industry.

The Board would be comprised of representatives of broker-dealers, banks, and the public, including issuers of and investors in municipal securities. (Sec. 15B(b)(1)) The procedures to be followed in the nomination and election of members of the Board would be designed to assure fair administration of the Board and fair representation of all segments of the municipal securities industry. (Sec. 15B(b)(2)(B)) The Board would be authorized to hire appropriate staff and to assess municipal securities dealers to cover reasonable expenses. (Secs. 15B(b)(2)(I) and (J))

The Board's rulemaking powers would be extensive. (Sec. 15B(b)(2)(A)-(K)) The purposes for which the Board could exercise its rulemaking authority would include prevention of fraudulent and manipulative acts and practices; promotion of just and equitable principles of trade; establishment of standards for entry into the municipal securities business; regulation of selling and underwriting practices; procedures for arbitration of intra-industry disputes; and determination of the frequency and scope of inspections of municipal securities dealers by the bank regulatory authorities with respect to banks and the National Association of Securities Dealers (the "NASD") with respect to securities firms.

#### *C. SEC Oversight of the Board*

The SEC's powers over the Board would be identical to those the SEC would have over other self-regulatory organizations. For example, the Board could not adopt or change any rule without prior SEC review and approval. (Sec. 19(b)) In addition, the SEC could, in accordance with statutorily prescribed procedures, abrogate, add to, or delete from the rules of the Board in any respect consistent with the purposes of the Exchange Act. (Sec. 19(c)) The SEC would also have the authority to remove from office or censure any member or employee of the Board for willful violation of the Exchange Act or rule of the Board or for willful abuse of authority. (Sec. 15B(c)(8)) The SEC's direct rule-making authority with respect to municipal securities would be limited to the control of fraudulent, manipulative, and deceptive acts and practices. (Secs. 15(c)(1) and (2))

#### *D. Inspection and Enforcement Responsibilities: Cooperation and Consultation Among Federal Agencies*

The Board would have no power to conduct inspections or to enforce its rules. Instead, the bill would assign these responsibilities to the NASD for securities firms which are members of the NASD. (Secs. 15A(b)(7) and 15B(c)(7)) Similarly, such responsibilities would be assigned to the bank regulatory agencies for municipal securities dealers which are banks. (Secs. 15B(c)(5) and 17(b))

The SEC would have the power to review enforcement actions taken against a municipal securities dealer by the NASD (Sec. 19(d)), but not those taken by a banking agency. However, the SEC would have the

authority to institute independent action against any municipal securities dealer; provided, in the case of a bank, that the SEC first give notice to and consult with the appropriate banking agency. (Secs. 15B(c)(2) and (6)) Similarly, the SEC would have the power to inspect any municipal securities dealer, provided, in the case of a bank, it first gives notice to and consults with the banking agency. (Sec. 17(b)) The bill would require the Commission and the banking agencies to exchange inspection reports and other relevant information. (Sec. 17(c))

### VIII. INSTITUTIONAL DISCLOSURE

The bill would amend Section 13 of the Exchange Act to require institutional investment managers, as defined in section 13(f)(5), to file reports with the SEC disclosing their securities holdings and securities transactions.

#### *A. Jurisdictional Tests and Reporting Requirements*

Every institutional investment manager which uses any means of interstate commerce in the course of its business and which exercises investment discretion, as defined in section 3(a)(25), with respect to accounts holding at least \$100 million of equity securities registered under the Act or issued by an insurance company or closed-end investment company (collectively referred to as "section 13(d)(1) securities") would be required to file disclosure reports with the SEC. The SEC would have rulemaking authority to raise or lower the \$100 million jurisdictional amount, but in no event could it require reports from persons exercising investment discretion over less than \$10 million of section 13(d)(1) securities.

Institutional investment managers satisfying the jurisdictional tests would be required to disclose their holdings of section 13(d)(1) securities. In addition, the SEC could require such institutional investment managers to disclose additional information including their holdings of other securities, their voting power with respect to section 13(d)(1) securities, and the details of any transaction in a section 13(d)(1) security involving at least \$500,000. (Sec. 13(f)(1))

#### *B. SEC Power to Exempt*

The SEC would be empowered to exempt any institutional investment manager or security from any or all of the provisions of the subsection. (Sec. 13(f)(2))

#### *C. Public Disclosure of Reports; Confidentiality of Information*

All information filed with the Commission would be publicly available promptly after filing in such form as the Commission prescribes, subject to confidential treatment in appropriate cases. The SEC would be required to tabulate the information in a manner which enhances its usefulness to other federal and state authorities and the public. (Sec. 13(f)(3))

#### *D. Standards for SEC Action; Coordination of Reports*

The Commission would be required to exercise its authority under the section in the public interest and for the protection of investors or to maintain fair and orderly markets. In exercising this authority,

the Commission would be directed to take such steps as are within its power to achieve uniform, centralized reporting of information concerning the holdings and transactions of institutional investment managers, to eliminate duplicative reporting, and to minimize the compliance burdens on institutional investment managers. The Commission would be expressly directed to consult with other federal and state authorities and national securities exchanges and registered securities associations in this regard.

Finally, institutional investment managers which are FDIC insured banks would file copies of all reports with the appropriate bank regulatory agency. (Sec. 13(f)(4)).

#### E. Annual Reports to the Congress

The Commission would be required to report to the Congress on its use and dissemination of information filed pursuant to this subsection. (Sec. 23(b)(9))

#### F. Definitions

"Institutional investment manager" would be defined broadly to include any person exercising investment discretion with respect to any account of any other person. (Sec. 13(f)(5)(A)) "Investment discretion" would be defined to mean *de jure* or *de facto* power to select the securities to be purchased or sold by an account. In addition, the SEC would have the power to include in the definition of "investment discretion" other appropriate forms of influence over the purchase or sale of securities. (Sec. 3(a)(35)). Specifically excluded from the definition of "investment discretion" would be discretion exercised outside the United States with respect to an account outside the United States, but the SEC would have the power, by rule, to subject such discretion to the requirements of the subsection as necessary to prevent the evasion of its purposes. (Sec. 13(f)(5)(B))

### IX: SALE OF INVESTMENT COMPANY ADVISERS FOR PROFIT

The bill would clarify the law in light of the 1971 decision of the Court of Appeals for the Second Circuit in *Rosenfeld v. Black*, 445 F.2d 1337 (2d Cir. 1971) by removing the uncertainty surrounding the circumstances in which an investment adviser of an investment company can receive any profit upon the transfer of its business without incurring liability to the company or its shareholders.

The bill would make clear that an investment adviser can make a profit on the sale of its business subject to two principal safeguards to protect the investment company and its shareholders. (Sec. 25 of the bill) The first safeguard would require that 75 percent of the investment company's directors be independent for a period of three years after the investment adviser sells its business or otherwise transfers the advisory relationship. The second safeguard would provide that such a transaction must not impose any unfair burden on the investment company.

The bill would also extend the protection against liability to corporate trustees who perform the functions of investment adviser for an investment company organized as a common law trust. The bill would provide a limited exemption from the 75 percent-independent-

board-of-directors requirement for transfers of controlling blocks of the stock of an investment adviser or corporate trustee where the transferee is the adviser or trustee or an affiliated person who is a natural person who has controlled or shared control of the adviser or trustee for 6 months prior to transfer. The bill would also make technical amendments to sections 9 and 36 of the Investment Company Act to make it clear that the provisions dealing with persons barred from serving investment companies and breaches of fiduciary duty apply to a corporate or other trustee performing the functions of investment adviser, as well as to an investment adviser.