APPROVED
JUN - 4 1975

6/5/75

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

MAY 30 1975

MEMORANDUM FOR THE PRESIDENT

5/5/75

Subject: Enrolled Bill S. 249 - Securities Act Amendments of 1975
Sponsors - Sen. Williams (D) New Jersey, Sen. Brooke (R) Massachusetts, and Sen. Tower (R) Texas

Last Day for Action

June 4, 1975 - Wednesday

Purpose

Authorizes the establishment of a national securities market system and a transaction clearing and settlement system; requires the elimination of fixed brokerage commission rates; requires the registration of municipal securities brokers and dealers; prohibits self-dealing and the combination of brokerage and money management by exchange members; requires public disclosure of holdings and transactions by institutional investors; and authorizes SEC appropriations for fiscal years 1976 and 1977.

Agency Recommendations

Office of Management and Budget	Approval (Signing Statement attached)
Department of the Treasury	Approval
Securities and Exchange Commission	Approval
Department of Justice	Approval
Council of Economic Advisers	Approval
Federal Home Loan Bank Board	Approval
Federal Reserve Board	No objection (Informally)
Department of Labor	Defer (Informally)
Federal Trade Commission	No comment (Informally)
Federal Deposit Insurance Corporation	No objection (Informally)

Discussion

S. 249 is the result of ten years of effort on the part of the Executive Branch and the Congress to produce comprehensive legislation that goes far toward modernizing regulation of the securities industry.

The bill calls on the SEC to supervise the establishment of a national market system, one in which ultimately all quotations and sales transactions for common and preferred stocks, bonds, debentures, warrants, and options would be available to interested buyers and sellers through an interconnected information network. It would further require that public orders (as distinguished from members' orders) receive priority. The objective would be to provide investors the opportunity to buy and sell at the best prices available. S. 249 would accomplish this by directing the SEC to work with the securities industry to facilitate the establishment of such a system, rather than by directing the SEC to implement one directly. It would rely on competition and self-regulatory bodies to a great extent but also would strengthen SEC's oversight and regulatory powers to ensure that the bill's key ingredients in such a system, i.e., a composite quotation or transactional reporting system, would be implemented.

Registration of exchanges and associations

S. 249 would require that exchanges, securities associations, and self-regulatory organizations of brokers and dealers continue to register with the SEC. The bill would restrict the authority of these groups, however, to limit their membership. An exchange would not be allowed to decrease its membership below that of May 1, 1975, and could be required to increase it if the SEC determined that an increase was necessary in order to remove impediments to competition. An association could restrict membership to those engaged in certain types of businesses but could not deny membership to registered brokers or dealers solely because they engaged in another business in addition to the qualifying business activity.

The bill would require the SEC to review all existing exchange and association rules and regulations within 180 days of enactment to determine if they were anti-competitive. It would also require the SEC specifically to approve any proposed rule changes or to start administrative proceedings to determine why they should not be approved within 35 days. SEC would be required to reach a decision on proposed rule changes within 180 days. Provisions for extensions of these periods and for judicial review of such decisions are included. Of particular concern to the Congress, as noted in the conference report, are rules which would prevent an exchange member from trading an exchange-listed stock anywhere except on that exchange, effectively limiting members from searching out the best price for their customers.

Information and handling

One of the assumptions behind the prolonged effort leading to this bill has been that an effective national market system must be supported by a national information system so that brokers and dealers know where the best price is available. The SEC would be given authority to regulate securities information processors, i.e., those organizations engaged in collecting, processing, or publishing information relating to quotations for securities and previous transactions. It was the intent of the Congress that SEC efforts be directed at ensuring that various exchange or other information systems be compatible with each other and provide the broker or dealer with adequate information to complete his transaction.

It has also been assumed that a national market system must have an efficient system for clearing and settling transactions and transferring ownership of securities. S. 249 would give the SEC general regulatory authority over all facets of the securities handling system, including clearing agencies, securities depositories, and transfer agents.

Although the SEC would have limited inspection powers over all institutions, the existing bank regulatory agencies would continue to inspect those financial institutions which are otherwise subject to their purview whose functions also included transfer or deposit of securities. This provision represents a compromise, reflecting views of the Comptroller of the Currency and the bank regulatory agencies. SEC would have preferred to have full regulatory and inspection authority in SEC.

Fixed commission rates

The bill would require the elimination of fixed commission rates for public brokerage services as of the date of the bill's enactment. However, it would allow members acting as brokers on the floor of an exchange for other members or as oddlot dealers to continue fixed rates until May 1, 1976. The bill would give the SEC authority by rule to reimpose fixed rates for transactions involving amounts of up to $300,000 until November 1, 1976, if it determined that they were in the public interest. After November 1, 1976, fixed rates could be reimposed only after a more formal proceeding that determined the rates were reasonable in relation to the service and that they were necessary to achieve the goals of the securities acts, as amended.

The SEC administratively eliminated public fixed rates as of May 1, 1975. There was much outcry from the industry that the SEC did not have the authority to require competitive rates and

an expectation that the SEC action would be subject to extensive court challenges. Because S. 249 which clarifies SEC's authority was about to become enrolled, those threatened court actions did not materialize.

An important adjunct to the abolition of fixed rates is a provision clarifying the right of money managers to pay more than the lowest brokerage fee available, if research services are also provided. Under fixed commission rates, research services were often provided at no extra cost as a means of attracting more customers. Under the new system of competitive rates, fiduciaries may pay a higher commission rate than the lowest available, provided that the rate is determined "reasonable" and that other services such as research or custody are also included. Federal or State laws prohibiting such higher payments would be void unless enacted after the date of enactment of S. 249

Third market trading

The bill would authorize the SEC to prohibit "third market trading," (that not on a national exchange) if SEC determined after an "on the record" proceeding that such trading was causing serious disruptions in the markets for listed securities (those traded on an exchange). The Conference Committee report on the enrolled bill states "These provisions are generally referred to as 'failsafe powers,' reflecting the expectation that they are provisions which may only be used as regulatory powers of last resort."

Institutional members

The bill would restrict self-dealing by exchange members effective on the date that fully competitive rates are established. Allowing for certain exceptions and exemptions, the bill would prohibit members from making transactions on an exchange for their own account, or the account of an "associated person." This provision would effectively prohibit such institutions as insurance companies or mutual funds from obtaining exchange seats. Under fixed rates, it became desirable for such institutions to seek exchange seats in order to recapture the large volume of commission dollars paid in trading their portfolios. Treasury and Justice had strongly supported tying the elimination of institutional membership and self-dealing to the elimination of fixed rates.

In addition, S. 249 would prohibit members dealing for an account in which they or an associated person exercised investment discretion. In effect, it would require the separation of money

management and brokerage services. This latter provision was deemed necessary to eliminate possible conflicts of interest brought about by a money manager earning brokerage fees by "churning," or excessively turning over an account's portfolio.

Registration of brokers and dealers

S. 249 would require all brokers and dealers (whether firms or individuals) to register with the SEC and would require the SEC to take affirmative action on all applications. Within 45 days the SEC must either approve the application or start administrative action to determine whether it should be denied. Such review would have to be completed within 120 days. Within 6 to 12 months of an approval, the SEC would be required to conduct an inspection to see if the broker or dealer was conforming to all applicable rules and regulations. The provision would also require the SEC to issue minimum capital requirements for brokers and dealers and authorize it to prescribe minimum training and competence standards.

Municipal securities

S. 249 would require securities firms and banks which underwrite and trade securities issued by States and municipalities to register with the SEC. The exemption for issuers of municipal securities would continue. The provision would establish a 15-member self-regulatory Municipal Securities Rulemaking Board with broad rulemaking, but no enforcement or inspection, authority. SEC oversight would be the same as for other self-regulatory bodies. The SEC would be responsible for inspection and enforcement with respect to dealers which are securities firms and would share that authority with bank regulatory agencies for those dealers organized as banks.

Institutional investors disclosure

S. 249 would require large institutional investors to report their holdings and transactions to the SEC. It would require investors having a portfolio worth $100 million or executing a transaction of at least $500,000 (or such lower amounts as SEC prescribes) to report to the SEC. All information would then be publicly available, except under limited circumstances. Treasury, in letters to both Houses, supported such disclosures for holdings, but opposed it for transactions. Transactional disclosure could place some investors at a disadvantage by helping to reveal the investment strategy of the institutions which manage their funds.

National Market Board

S. 249 would authorize the establishment of a 15-member advisory committee, the National Market Board. In addition to advising the SEC on proposed exchange and association rule changes and the future of the national market system, the Board would be authorized to conduct a feasibility study of the need for a new self-regulatory body to administer the system. Treasury opposed the creation of a new regulatory organization because the SEC has already used its authority to appoint advisory committees and because it was felt that the Board would be strongly inclined to recommend its own continuance. The enrolled version, however, is an improvement over the original Senate version because it establishes an advisory committee rather than a new self-regulatory body immediately.

SEC authorizations

S. 249 would authorize appropriations for the SEC of $51 million for fiscal year 1976 and $55 million for 1977. The Administration's proposed budget called for $47.2 million for 1976 and $49.2 for 1977. The SEC has estimated that it would cost an additional $4 million per year to implement this bill.

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This enrolled bill is a major first step in regulatory modernization of the securities industry. While it increases regulation in some areas, (e.g., adding control over dealers in municipal securities) it goes far toward removing impediments to competition which have grown up throughout the industry.

It will be a large aid in helping the industry keep pace with the changing American economy and technology and ensuring that the consumer receives the benefits of better service and generally lower prices. We recommend that you take this opportunity to draw attention to the need for similar reforms in other industries by highlighting the pro-competitive and investor protection features of this bill and by urging the SEC to continue to press for quick implementation of the National Market System. A draft signing statement is attached for your consideration.

James M. Frey

Assistant Director
for Legislative Reference

Enclosures