

SIPC

INFORMATIONAL MEMORANDUM

MR-78-43

November 30, 1978

TO: The Commission

FROM: The Division of Market Regulation

SUBJECT: Effect of the Bankruptcy Act
Amendments on the Securities
Investor Protection Act.

SIP
H. M. Stone

INTRODUCTION

As you may be aware, the President recently signed into law a substantial revision of the Bankruptcy Act. Since the Securities Investor Protection Act of 1970 ("SIPA") 1/ is affected by the Bankruptcy Act, 2/ the new law includes certain amendments conforming SIPA to the new Bankruptcy Act.

As originally passed by both houses of Congress the bills, although taking SIPA into account generally, did not reflect the amendments to SIPA enacted in May, 1978. 3/ Accordingly, the Securities Investor Protection Corporation ("SIPC"), at the last minute, submitted amendments to Congress to conform these bills to the amended SIPA. Congress adopted SIPC's proposed changes in the final bill and added a provision detailing the SIPC trustee's responsibility when the debtor is both a stockbroker and a commodity broker. The transition to the new bankruptcy system begins, and the SIPA amendments will become effective on, October 1, 1979.

1/ 15 U.S.C. §§78aaa et seq.

2/ Under Section 6(b) of SIPA, the Bankruptcy Act (now referred to as "title 11 of the United States Code") controls liquidations to the extent consistent with SIPA.

3/ Securities Investor Protection Act Amendments of 1978, Pub. L. No. 95-283.

Due to the delay in printing the law the Division, until now, has been unable to inform the Commission of the outline of the amendments to SIPA.

DISCUSSION

(1) The Bankruptcy Court

The most substantive change relates to the restructuring of the bankruptcy courts. Under the current SIPC Act application for a protective decree is made to the federal district court and the liquidation is carried out under that court's jurisdiction; however, reference is normally made to a referee in bankruptcy. The bankruptcy court will now be partially independent from the federal district court and will have jurisdiction over all bankruptcy matters.

Since the district courts are relinquishing jurisdiction over bankruptcy matters, district courts will no longer be the proper forum in which to conduct a SIPC liquidation proceeding. To deal with the problem created by separating the bankruptcy courts from the district courts Congress established a new procedure entitled "Removal to Bankruptcy Court." SIPC will still file its application in the district court and that court will make the decision of whether to grant a protective decree. If such a decree is granted the court will also appoint a trustee. The district judge must then remove the action to the new bankruptcy court which will preside over the liquidation.

The alternative to the bifurcated procedure would be to bring the action originally in the bankruptcy court. SIPC gives three reasons why it chose not to propose this. First, SIPC desired to retain the benefits of coordinating its liquidation proceeding with a Commission enforcement proceeding. Under Section 5(a)(4) of SIPA, a SIPC proceeding "may, with the consent of the Commission, be combined with any action brought by the Commission, including an action by the Commission for a temporary receiver" Section 5(b)(1) of SIPA provides, inter alia, that a protective decree will be issued if the court finds a violation of the financial responsibility or securities hypothecation requirements of the Securities Exchange Act of 1934. If the Commission establishes such

a violation in an enforcement proceeding, coordinating the action relieves SIPC of the burden of independently establishing such a violation. Since the Commission brings enforcement actions in the district courts, establishing original jurisdiction for SIPC proceedings in another forum would have imposed procedural burdens in coordinating the two actions.

Second, SIPC foresaw possible political problems in effecting major changes in the jurisdictional requirements, arising from the fact that a different subcommittee was amending the bankruptcy matters than had drafted the SIPC Act.

Third, SIPC had a limited time frame in which to propose amendments. A change in the initial jurisdiction over a liquidation proceeding would have entailed a significant revision of SIPA which was not feasible in an eleventh-hour effort.

Appointment of the trustee was retained in the district court because it is essential that a trustee be appointed immediately after a protective decree issues. To delay the appointment until after removal to the bankruptcy court, it was feared, would entail too much delay.

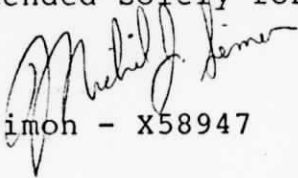
Congress also modified the direct payment procedures slightly. Under Section 10 of SIPA, SIPC can pay customers directly without a liquidation proceeding. The SIPC Act currently permits dissatisfied customers to appeal SIPC determinations to the district court. Under the new procedure the bankruptcy courts will now hear such appeals.

2. Commodity Brokers

Even though a SIPC-liquidated broker-dealer had been involved in the sale of both securities and commodities, SIPC trustees to this time have liquidated the entire business. SIPC would advance funds to satisfy only the claims of securities customers, however. Chapter Seven of the new Bankruptcy Act contains separate subchapters for stockbroker liquidations and commodity broker liquidations. The Senate Judiciary Committee was

concerned that SIPC's right to liquidate the commodity business of a broker-dealer might be drawn into question. As a result, Section 7(b) of SIPA was amended to require the SIPC trustee to liquidate the commodity portion of the broker-dealer business. As noted, this does not change current practice and is intended solely for clarification.

Prepared by: Michael J. Simon - X58947

A handwritten signature in cursive script, appearing to read "Michael J. Simon", is written over the typed name in the signature line.