EXECUTIVE OFFICE OF THE PRESIDENT

OFFICE OF MANAGEMENT AND BUDGET

WASHINGTON, D.C. 20503

MAY 19 1978

MEMORANDUM FOR THE PRESIDENT

Subject: Enrolled Bill H.R. 8331 - Securities Investor Protection Act Amendments of 1978
Sponsor - Rep. Eckhardt (D) Texas

Last Day for Action

May 26, 1978 - Friday

Purpose

(1) Amends the Securities Investor Protection Act to streamline the Act's liquidations procedures, generally reduce the expense and complexity of the procedures under the Act, and provide public customers of failing brokerage firms with increased and improved insurance coverage; and (2) extends certain effective dates and dollar limitations contained in the Securities Act and the Securities and Exchange Act.

Agency Recommendations

Office of Management and Budget	Approval
Securities Investor Protection Corporation	Approval
Securities and Exchange Commission	Approval
Department of the Treasury	No objection
Department of Labor	No objection
Department of Commerce	No objection(Informally)
Small Business Administration	No objection
Federal Reserve Board	No objection(Informally)
Department of Justice	Defers

Discussion

The enrolled bill is principally intended to improve the protection against losses afforded securities customers by the Securities Investor Protection Corporation (SIPC) by enabling the SIPC to perform its role more expeditiously and efficiently in the administration of the Securities Investors Protection Act (SIPA).

In 1970, Congress enacted the Securities Investor Protection Act establishing the Securities Investor Protection Corporation, in response to the Wall Street "back office" crisis and the bear market of the late 1960's. During this turbulent period, hundreds of brokerage firms went out of business. Their public customers were exposed to serious financial losses and public confidence in the securities markets was shaken badly.

SIPA was considered and adopted on an emergency basis in order to restore public confidence in the securities markets and protect public investors against the failure and insolvency of brokers and dealers. Under the statute, the Securities Investor Protection Corporation 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 8 years have been liquidated under the Act. Significant amounts of securities and cash in the debtor's possession have been distributed to customers by the trustees. SIPC estimates 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. In short, SIPC has protected investors against loss ~~in the manner~~ envisioned and at no cost to the taxpayer.

However, because of the need for prompt action in 1970, it was recognized that certain technical problems relating to the procedures for liquidating securities firms would be left for later resolution in light of actual experience under the Act. H.R. 8331 would achieve those and other necessary revisions to the original 1970 Act, as follows.

First, the bill would increase the extent of SIPC protection for customers' cash and securities in an account with a broker-dealer. As noted above, the Act currently protects customer accounts up to a total of $50,000, with a ceiling of $20,000 for cash. H.R. 8331 would double the amount of protection, raising to $100,000 the total amount of protection, and to $40,000 the level of protection for customers' cash. This corresponds to the changes in 1974 in the Federal Deposit Insurance Corporation (FDIC), and Federal Savings and Loan Insurance Corporation (FSLIC) legislation which doubled the coverage of depositors.

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 considerable 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.

Finally, SIPC's experience in liquidation proceedings to date demonstrates that many problems arise, and can be expected to arise in the future, which are not subject to statutory determination. Therefore, the bill would give SIPC substantive rulemaking authority, including authority to make rules relating to the definition of terms used but not defined in the Act and to the procedures for the liquidation of broker-dealers and the conduct of direct payment procedures. The bill sets forth procedures whereby such rules are submitted to the Securities and Exchange Commission and generally published for public comments prior to approval or disapproval by the Commission. Upon approval, the rules have the force and effect of law.

Because of the jurisdictional and practical difficulties which would be involved should SIPC ever have to undertake the liquidation of a foreign broker-dealer, the bill would exclude from SIPC membership those broker-dealers whose principal business, in the determination of SIPC and subject to Commission review, is conducted outside of the United States and its territories and possessions. SIPC is required to provide that such foreign broker-dealers may become members of SIPC under terms and conditions specified by SIPC by rule.

The bill would also make other technical changes in the present act.

The enrolled bill also contains two non-SIPA amendments. The first would amend section 3(b) of the Securities Act of 1933 to assist small businesses in raising capital by increasing from $500,000 to $1.5 million the aggregate amount of an issue which may be exempt from the full registration and prospectus requirements of the 1933 Act. Twice in the past, the ceiling on the exemption from these requirements (known as Regulation A) has been raised in recognition of changes in general economic conditions and the increased costs of conducting business. Eight years have passed since the last raise in the ceiling--to $500,000--and in the interim there has been a sharp decline in the real value of this sum to small business, thus necessitating the proposed adjustment in the exemption ceiling to $1.5 million.

The second amendment would extend for 9 months, until February 1, 1979, the effective date of section 11(a) of the Securities Exchange Act of 1934. This section prohibits a member of a national securities exchange from effecting any transaction on the exchange for the member's own account, the account of a person associated with this member, or, an account with respect to which the member or an associated person exercises investment discretion. Section 11(a) was enacted in the Securities Act Amendments of 1975 (Public Law 94-29) and became effective immediately upon its enactment with respect to those who became exchange members after May 1, 1975, but its effectiveness was delayed until May 1, 1978, with respect to pre-May 1, 1975 members.

The proposed 9 month delay in the effective day of section 11(a) is partly in response to the Securities and Exchange Commission's (SEC) request to the Congress for a delay until November 1, 1979, which was based on:

-- the possible adverse impact that the section would have upon the national market system for securities;

-- the unintended anti-competitive effects that implementation would have, particularly with respect to smaller and regional firms, resulting in further concentration within the securities industry; and

-- the concern that since section 11(a) applies only to brokerage transactions by members of national securities exchanges, member firms which rely heavily on revenue derived from money management would resign their exchange membership to preserve these revenue sources, thus weakening the entire exchange structure.

The proposed 9 month delay is also required because the SEC's tardy adoption (on March 14, 1978) of the rules implementing section 11(a) effectively prevented firms from making the necessary business adjustments--such as reprogramming systems and renegotiating customer contracts--in order to comply with this section by May 1, 1978.

The final version of the bill passed both Houses by voice vote.

(Signed) James M. Frey

James M. Frey
Assistant Director for
Legislative Reference

Enclosures