To Our Clients

Recent Developments

(1) Repurchases of Securities by Brokers. The SEC Staff takes the position that repurchases by publicly owned brokers of their own securities raise special problems and accordingly, may be made only under special conditions more restrictive than those applied to nonbroker companies. In addition to the limitations of proposed rule 13e-2, the Staff requires that the purchases be made by a person independent (within the meaning of 13e-2(c)) of the broker and, except for unsolicited block purchases, not be executed through the broker. Further no repurchases may be made if they would cause the broker's net capital ratio to be more than 10-1. First of Michigan Corp. CCH ¶ 79,502 (Avail. Aug. 25, 1973)

(2) Rule 144 - Filing Extensions. An issuer is not "current" within 144(c) during the period of an extension; it is current when the filing is made. Project 7, Inc. CCH ¶ 79,506 (Avail. Aug. 20, 1973)

(3) Life Insurance Company Accounting. The SEC has proposed to amend Reg. S-X to require life companies to use GAAP in preparing their financial statements and to end the exemption from certification. A number of other reporting and disclosure proposals are included. SA Rel. No. 5420 (Sept. 12, 1973)

(4) Financial Statement Disclosure of Income Tax Expense. The SEC has revised its previous proposal to require more detail in reporting income taxes. It is now proposed that a five year projection of the flow of the deferred tax account to expense be shown and that there be a detailed reconciliation of financial statement tax expense to theoretical tax expense with a proviso that unless otherwise significant no reconciliation is required if the amount involved is less than 5% of theoretical taxes. SA Rel. No. 5421 (Avail. Sept. 12, 1973)

(5) Institutional Membership - Rule 19b-2 - Affiliated Persons. The SEC has rejected the NYSE interpretations of Rule 318 which would presume affiliation if the management arrangement reduced mobility of the account or the managers had other relationships such as banking, insurance or investment banking with the account or if state law made a separate account the property of the insurance company. The SEC noted that Sen. 470 and House 5050 would enact the NYSE approach, but that from an administrative policy standpoint the SEC would continue to follow the 19b-2 approach of actual control and that the burden is on the exchanges to show control as a matter of fact. EA Rel. No. 10391 (Sept. 13, 1973)

(6) Brokers Financial Reports. The SEC has proposed, EA Rel. No. 10392 (Sept. 14, 1973), a revision of Form X-17A-5:

(a) Requiring separate reporting of the components of the 15c3-3 reserve calculation.

(b) Requiring separate reporting of clearing balances representing securities loans or fails.

(c) Clarifying the audit requirements.

(d) Changing a number of the specific reporting requirements.

On Sept. 20, 1973 the SEC adopted the changes in Rule 17a-5 and Form X-17A-5 proposed in July and discussed in a previous memo, EA Rel. No. 10398 (Sept. 20, 1973). See NYSE M.F. Ed. Cir. No. 432 (Sept. 27, 1973)

(7) Hughes v. Dempsey - Tegeler & Co. CCH ¶ 94,133 (C.D. Cal. Sept. 4, 1973) denied recovery against the NYSE to a D-T customer who subordinated his account shortly before D-T was placed in liquidation. The court says that an account subordination is a security, there is an implied right of action for damages against an exchange that fails to exercise its § 6 supervision obligations, control person liability is in addition to the common law concepts of agency and respondeat superior and § 12(2) and Rule 10b-5 disclosure requirements are not less for sophisticated investors and finds that the NYSE acted in good faith, discharged its supervision duties and the plaintiff was told the essential facts as to the condition and prospects of D-T.

(8) Broker's Responsibility for Employee Tipping. SEC v. Lums Inc., CCH ¶ 94,134 (S.D.N.Y. Sept. 13, 1973) holds that a firm which has an adequate compliance program is not liable as a control person under § 20(a) (rejecting respondeat superior as the appropriate theory) for the 10b-5 tipping violations of its employees. While the court rejects the argument that in 1970 such a program must have included a policy prohibiting salesmen from contacting issuers, it would appear that such a policy is necessary today. The decision points up the benefit of a good compliance program.

(9) Pooling of Interests. Arthur Andersen & Co. has filed a lawsuit attacking the SEC treasury stock interpretation of the pooling rules.

(10) Options - NYSE Margin Requirements. The NYSE has amended Rule 431 to provide that options will be considered unhedged for margin purposes unless written against a net long or short position and that short against the box and convertible hedge positions cannot be used to cover options. Options for more than six and ten and options on volatile securities or securities that present liquidity problems are subject to "substantial additional margin".

(11) Impact of Institutional Trading. In a statement to the House Banking Committee Chairman Garrett stated:

> "The acquisition and disposition of these positions often produces temporary imbalances in supply and demand with short term price impacts. Such effects are most often observed when institutions buy and sell large blocks of securities at discounts or premiums from the prevailing market price, but a similar effect can result when institutions acquire, or dispose of, individual securities over a long period of time. As this Committee is aware, one of the major purposes of the market's specialist and market making machinery is to absorb temporary imbalances in supply and demand and thus provide continuity and liquidity to the trading markets in particular securities. But the institutional decision immediately to acquire, or dispose of, vast amounts of a particular security puts great strain on that mechanism and often results in potentially harmful, temporary price volatility.

[W]hile the Commission feels that all investors, including institutions, generally should be free to trade at a time and in a manner of their own choosing, we are aware of the increasing strains which institutional trading activity has placed on various market mechanisms. In our view, a two-pronged regulatory approach is necessary, indeed vital, to cope with this strain: (1) A strengthening of the nation's market making mechanisms -- a course within the Commission's present jurisdiction and authority and upon which we have already embarked in our proposals for a central market system; and (2) full and complete disclosure of institutional trading activity, including that of bank trust departments -- a course which demands legislative action to complement our existing but not necessarily complete authority to regulate such disclosure.

The Commission believes that full public disclosure of institutional trading and portfolio positions -- a subject which needs close Congressional consideration -- may partially dispell a growing public concern over institutional domination of market trading, will increase the information available to all market makers and possibly improve the efficiency of the trading markets and will provide important information from which subsequent decisions can be reached with respect to what, if any, additional steps may be necessary or appropriate in the public interest."

M. Lipton