

To Our Clients

May 28, 1975

Securities Acts Amendments of 1975

The following is an outline summary of the Amendments:

National Market System:

No specific system is mandated, but the SEC is given specific authority to facilitate the creation of a national market system by being empowered to require composite tapes and consolidated reporting systems and to regulate all securities information processors.

The SEC is required to appoint a 15 member National Market Advisory Board to advise it as to the development of the national market system and as to significant regulatory proposals filed by national exchanges and the NASD. The Board is authorized to conduct a feasibility study of the need for a new self-regulatory body to administer the national market system and report its recommendations to Congress by December 31, 1976.

Separation of Investment Management and Brokerage:

After May 1, 1978, exchange members will not be able to do brokerage for managed or affiliated accounts. All managed accounts -- whether fully discretionary, discretionary subject to ratification or merely influenced -- other than accounts of natural persons -- are subject to the prohibition. The exceptions to the affiliated account prohibition are market maker, stabilizing, arbitrage, odd-lot and error transactions. The SEC is instructed to prevent institutions which were not members on May 1, 1975 from becoming members for the purpose of doing brokerage for managed or affiliated accounts during the three-year period before the prohibition becomes effective. The Conference Report specifically enjoins the SEC from broadening the exceptions - apparently to prevent the SEC from permitting brokers to manage accounts and do the brokerage for an all-inclusive management fee. The Conference Report also requests Labor and IRS to conform ERISA to the May 1, 1978 date for the phase-out of the combination of management and brokerage.

Competitive Rates:

Fixed commissions are prohibited except that fixed intra-member rates are permitted to continue until May 1, 1976. However, the SEC may permit the reimposition of fixed rates

prior to November 1, 1976 if it finds that such reimposition is in the public interest. Thereafter, it may permit fixed rates if it finds that such rates "(i) are reasonable in relation to the costs of providing the service for which such fees are charged (and the Commission publishes the standards employed in adjudging reasonableness) and (ii) do not impose any burden on competition not necessary or appropriate in furtherance of the purposes of this title, taking into consideration the competitive effects of permitting such . . . rates weighed against the competitive effects of other lawful actions which the Commission is authorized to take under this title." Prior to November 1, 1976 the normal rulemaking procedures are to be followed with respect to any proposal to reimpose fixed rates. Thereafter, before permitting the reimposition of fixed rates the SEC must follow a more formal procedure although not a full hearing on the record.

Paying-Up for Research:

Investment managers are specifically authorized, with full preemption of statutory and common law to the contrary, to pay-up for research. The Conference Report specifically negates the resurrection of give-ups.

NYSE Rule 394:

The provision contained in the House Bill prohibiting an exchange from limiting a member's ability to transact business off board has been dropped. However, the SEC is directed to review rules which limit or condition the execution of transactions off board in light of the competitive standards in the Exchange Act and on or before the 90th day after enactment of the Amendments to report to Congress the results of its review and commence a proceeding to amend any such rule if such rule does not meet the requirements of the Exchange Act.

Institutional Membership:

All affiliation and nature-of-business barriers to exchange membership are outlawed. The only permitted restrictions on exchange membership are competence and capital.

An exchange is permitted to limit the number of its members (including floor members) except that an exchange cannot decrease the number of its members below the number in effect on May 1, 1975 or the date of the exchange's registration, if later, and except that the SEC can require an exchange to increase the number of its members (including floor members) if the SEC determines that the limitation imposes burdens on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.

Sale of Advisers to Investment Companies:

Rosenfeld v. Black is abandoned and an investment adviser may now be sold for more than book value if for three years after the sale 75% of the directors of the investment company are disinterested and the sale does not impose any "unfair burden" on the investment company. An "unfair burden" includes any arrangement during the two-year period after the transaction whereby the adviser is entitled to receive any compensation directly or indirectly (i) from any person in connection with the purchase or sale of securities or other property to, from or on behalf of such company, other than bona fide ordinary compensation as principal underwriter for such company, or (ii) from such company or its security holders for other than bona fide investment advisory or other services. The 75% and unfair burden tests are not applicable to a public offering by an adviser which does not result in change in control.

Separation of Broker and Dealer Functions of Specialists and Market Makers:

The SEC is given authority to limit specialist activities to those of a broker or a dealer and to prohibit a dealer in a security from acting as a broker in the same security.

Regulation of the Third Market:

The SEC is given the power, after prescribed proceedings, to protect exchanges by proscribing third market dealings in exchange listed securities. The Conference Report states that these are "failsafe" powers to be exercised only as a "last resort."

Uniform Capital Rules:

The SEC is required to promulgate minimum capital rules for all brokers and dealers no later than September 1, 1975.

Portfolio Disclosure:

All investors, other than natural persons, and investment managers with \$100,000,000 portfolios (\$10,000,000 if the SEC so determines) must file such reports of portfolio holdings and transactions as the SEC specifies.

Registration of Brokers and Advisers:

The registration provisions of the Exchange Act and the Advisers Act have been coordinated. The statutes now set forth the information to be filed to effect registration. Registration is no longer automatic; it now requires affirmative action by the SEC within 45 days to either grant registration or start proceedings to deny.

Regulation of Transfer and Clearance:

The SEC is given extensive regulatory power with respect to issuance, transfer, clearance and central deposit of securities, including the power to specify the form of certificates or to eliminate certificates. While the oversight and examination authority of the bank regulatory agencies was preserved, the initiative has passed to the SEC.

Securities Associations:

Associations, such as the NASD, are now authorized for particular types of business thus permitting self-regulatory associations for firms in specialized areas of the securities business.

SEC Oversight of Exchanges and Self-Regulatory Agencies:

The SEC is given greater oversight of exchange and self-regulatory agency rules and the power to promulgate such rules on its own initiative.

Judicial Review of SEC Rulemaking:

The amendments expand the scope of judicial review of SEC rulemaking. However, the antitrust problem was not directly confronted and the SEC and the courts are left to ad hoc determinations as to the proper balance between regulation and restraint on competition.

Supervision of Employees of Broker-Dealers and Advisers:

The importance of compliance procedures and manuals evidenced by the Lums and Geon cases is emphasized by the provision that a person does not violate his supervision obligations in connection with a violation by another person if "there have been established procedures, and a system for applying such procedures, which would reasonably be expected to prevent and detect, insofar as practicable, any such violation by such other person"

Injunctions:

The attempt to weaken the standard for SEC enforcement injunctions was defeated. At least in the Second Circuit more than just a past violation is necessary. The amendments prohibit the consolidation of SEC injunction actions as part of multi-district proceedings.

Broker-Dealer Financial Statements:

The SEC is given the power to prescribe uniform financial statements for broker-dealers.

Stock Loans:

The SEC is authorized to adopt rules regulating the lending of securities carried for the accounts of customers.

Local Transfer Taxes:

Local transfer taxes based solely on the location of a clearing house or transfer agent are prohibited.

SEC Transaction Fee:

The broker-dealer fee was raised from 1/500% to 1/300% of aggregate dollar sales of listed securities other than debt securities.

Unlisted Trading of OTC Securities:

The SEC may grant -- provided it finds that to do so would not restrict competition -- unlisted trading by an exchange of an OTC security.

Public Directors of Exchanges and Associations:

The Amendments require at least one public director. The Conference Report states that the requirement for only one public director is not meant to repudiate the balanced boards adopted by the NYSE and AMEX.

Arbitration:

The Conference Report states that there was no intention to affect the holding in Wilko v. Swan that a customer is not bound to arbitrate a claim based on a securities law violation.

Municipal Securities:

Dealers in municipal securities (including bank municipal departments) are now subject to registration and regulation under rules to be fashioned by a Municipal Securities Regulatory Board. Such dealers are also subject to enrollment in SIPC.

Mortgage Transactions:

The 1933 Act has been amended to provide a limited exemption from its registration requirements for sales (including participations) of promissory notes directly secured by a first lien on a single parcel of real estate on which is located a dwelling or other residential or commercial structure.

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