

MAR 11 1975

Honorable Hugh F. Owens, Chairman  
Securities Investor Protection Corporation  
900 Seventeenth Street, NW, Suite 800  
Washington, DC 20006

Dear Chairman Owens:

It was a pleasure to have you visit with the Commission on March 3, 1975 to review areas of mutual concern regarding the proposed amendments to the Securities Investor Protection Act of 1970. Your thoughtful discussion provided us with a better understanding of the purpose and possible impact of some provisions of the bill. Upon consideration, the Commission believes certain comments may be appropriate.

Initially, the Commission wishes to express its wholehearted support of the proposed amendments. The steps taken to increase the scope of customer protection and to limit the time required to satisfy customer claims are clearly in the public interest. Moreover, the proposals, in general, appear to carry out the policies recommended in July 1974 by the SIPC Special Task Force on which the Commission was represented.

We have the following comments on specific sections of the bill. References are to the pages of S. 4255, denoted by S. and the page number.

a. Proposed Section 3(e)(3)(S. 5) deals with rulemaking by SIPC. As drafted, the bill would require the Commission to promulgate as Commission rules, rules proposed by SIPC. The same procedures would apply as are applicable to Commission rulemaking, including publication in the Federal Register.

As we advised you, we suggest an alternative procedure generally similar to that proposed in S. 249 for the rules of self-regulatory organizations. Under the procedure we suggest, proposed rules would be submitted to the Commission and published in the Federal Register. Comments received would be reviewed by SIPC and the rule, revised where appropriate, would be resubmitted to the Commission. The rule would become effective unless disapproved by the Commission. We would also suggest that a procedure be included which would bypass the comment process for minor matters or matters primarily of a housekeeping nature. Such a procedure is provided in S. 249.

b. Proposed Section 6(c)(3)(S. 24) defines the term "securities" for purposes of the SIPC Act. The provision follows the Securities Exchange Act definition in general, but excludes, among other things, investment contracts, and certificates of interest or participations in a profit-sharing agreement, or in any oil, gas or other mineral royalty or lease.

We do not believe that these exclusions are appropriate. These terms are broad and it is difficult to predict accurately what these terms may encompass in the future. The SIPC Act in 1970 defined securities to have the same meaning as in Section 60(c) of the Bankruptcy Act and Congress evidenced an intention to provide the investing public with comprehensive coverage in regard to their securities and cash. We believe coverage should continue to be as comprehensive as possible. Customers should not deal with a broker-dealer at their peril not knowing whether a particular security which they purchase (or the proceeds from the sale of such a security) is protected by SIPC.

In regard to your expressed concern about commodities and commodity options, it is our understanding that the Commodities Futures Trading Commission Act of 1974 would bring such investments within the jurisdiction of the Commodities Futures Trading Commission. This might provide a simple mechanism for excluding commodity options from the ambit of SIPC protection.

In regard to the other exclusions from the definition of securities, however, we suggest that the exclusions be eliminated.

c. Proposed Section 6(c)(2)(S. 23) would extend SIPC protection to a customer whose claim arose after the filing date if the trustee found the customer had acted in good faith and prior to the appointment of the trustee. Proposed Section 9(a)(4)(S. 39) would authorize SIPC to refuse to advance funds for such customer's claim.

While we understand SIPC's desire to assure that fraudulent claims are not paid, we believe the burden of screening out such claims should be placed on the trustee subject to the supervision of the court. If the trustee makes a finding of good faith, the claimant should be elevated to the status of all other customers and should be entitled to receive full protection.

d. In Section 6(c)(1)(S. 22), "customers" is defined, in part, to be persons who have claims "on account of securities received, acquired, or held by debtor in the ordinary course of his business as a broker or dealer . . ." [emphasis supplied]. We understand that, in response to a comment of our staff, SIPC has suggested to the House and Senate Subcommittees that the word "his" be deleted. We are still concerned that insertion of the remaining phrase into the definition of customers may have unfortunate consequences.

It is our understanding that the purpose of the addition is to assure that persons who deal with the debtor other than in the relationship of broker-customer are excluded from coverage. We also understand that although it has generally entailed litigation, SIPC has to this time been largely successful in excluding such claims. Moreover, as you know, several cases have held that where a customer has acted improperly or illegally he may be denied SIPC protection. Section 6(c)(1), however, turns upon action by the broker-dealer rather than the customer.

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We do not believe that the potential clarification of the SIPC Act and elimination of litigation which might result from the addition of this language is sufficient to outweigh the concerns it raises.

Finally, you should be aware that some further analyses and comments may be made by the Commission during the legislative process. For example, as you may know, certain questions regarding the allocation of assets between customer property and the general estate have been raised. Your staff has submitted to our staff a number of memoranda discussing the point, but review has not been completed. In addition, the staff has a number of technical comments which, we are advised, will be conveyed to you informally.

I hope these comments will be helpful to you. I wish to reiterate the Commission's support for the provisions of the proposed amendments which enhance the protection of investors.

Sincerely,

Ray Garrett, Jr.  
Chairman

cc: Senate Subcommittee on Securities  
House Subcommittee on Commerce and Finance