MEMORANDUM

September 7, 1983

To: Chairman Shad

From: Dan Goelzer DGoelzer

Re: Securities Industry Association Recommendations to the Task Group on Regulation of Financial Services

Your memorandum of August 19, 1983, requests my views concerning the recommendations set forth in the SIA's August 3 letter to the Bush Task Group. My comments on each of the SIA's eleven points appear below, along with an indication concerning whether legislation would be required to implement each proposal. The advantages and disadvantages of each proposal are set forth in more detail in the attached memorandum from my staff.

1. Options Disclosure Document

While the underlying idea is sound, I do not believe that the Bush Task Group should address this issue.

The SIA recommends that the existing multiple disclosure documents describing the risks of each particular type of option trading be consolidated into a single document. This, the SIA urges, would permit broker-dealers to deliver only that single document to all options clients; at present, a firm must deliver each separate disclosure document to the customer as he or she becomes involved in different forms of options trading (e.g., foreign currency options, equity options, etc.).

In fact, however, it is the Options Clearing Corporation and the option exchanges, not the Commission, which require multiple documents and delivery of the specific disclosure document relevant to each particular type of options trading prior to a customer's trading in that type of option. While the Commission could, of course, force OCC and the exchanges to change their rules, it seems more appropriate for the SIA to work this problem out with the exchanges directly; obviously, the SIA's members are members of the various options exchanges. In any event, it does not seem a matter in which the Bush Task Group should become involved, since it does not directly involve any federal statute or Commission rule.

The SIA's proposal could be accomplished administratively through Commission rulemaking to abrogate the existing exchange procedures.

2. The Racketeer Influenced Corrupt Organizations Act

While I agree with the SIA's proposal, I do not feel that this is an issue on which it is appropriate for the Commission to take a position, since this agency does not administer RICO. I can, however, see no objection to its consideration by the Bush Task Group.

I agree with the SIA that RICO should permit treble damage civil recovery only to those plaintiffs injured as a result of a "pattern of racketeering activity." This would eliminate existing litigation against traditional businesses, including securities firms, which happen to engage in RICO predicate offenses, such as securities fraud. This office is preparing an analysis of the impact of RICO on securities litigation for Commission consideration.

This proposal would require legislation.

3. Dual Registration of Broker-Dealers as Investment Advisers

I agree with the thrust of this proposal, but not with the manner in which the SIA proposes that it be implemented. This does not seem to me a matter of sufficient importance to justify Task Group consideration.

I do not agree that broker-dealers should be exempted from registration under the Investment Advisers Act. The Advisers Act contains important protections, particularly in its antifraud prohibitions, which are not duplicated in the Securities Exchange Act. I do, however, agree that the paperwork burdens incident to dual registration should be eliminated by "integrating" broker-dealer and investment adviser registration.

Exemption of broker-dealers from provisions under the Investment Advisers Act would require legislation. Integration of the broker-dealer and investment adviser registration provisions could be implemented through Commission rulemaking.

4. Arbitration

I agree with the SIA on this point, although a recommendation that broker-dealers be permitted to obtain customer consent to compulsory arbitration would be controversial and, for the reasons discussed below, might not produce a result that would be worth the political cost.

In Wilko v. Swan, the Supreme Court held that an agreement to arbitrate claims arising under the federal securities laws was unenforceable, where the agreement was entered into before the dispute arose. The SIA recommends Congressional repeal of this holding. The advantages of compulsory arbitration would be greater speed and less cost for the parties and reduced burdens on the federal courts in resolving customer/broker-dealer claims under the federal securities laws. Congress would, however, I suspect, insist on extensive Commission involvement in any process by which customers waive their right to litigate and on Commission oversight concerning the fairness of the arbitration process. I think that, in the end, arbitration with extensive Commission oversight might turn out to be more of a headache for the securities industry than a benefit. As a general matter, however, I favor arbitration, rather than litigation, as a method of dispute resolution.

This change would clearly require legislation.

5. 1934 Act Section 13(f)

I do not feel that the Bush Task Group should support repeal of Section 13(f) at this time.

My sense is that Congress wants more, not less, disclosure of the activities and holdings of those who control large amounts of capital. The SIA's assertion that Section 13(f) is "without any demonstrable public benefit" is arguable; I suspect that many in Congress feel that the disclosure of the holdings of those with investment discretion over more than $100 million is, in itself, a public benefit. */

If Section 13(f) is to be successfully repealed, it could not be done on the basis of unsupported assertions of the type contained in the SIA's letter. I would suggest that you direct DEPA to prepare a study of the uses to which Section 13(f) disclosures are put, the costs of preparing this information, and the public benefits. Conceivably, an effective and well-documented study of this nature could serve as the basis for Congressional repeal or modification of Section 13(f). I think, however, that, for the Vice President's Group to recommend repeal at this time, without any such evidence, would be unsuccessful and would put the Administration in a bad light.

This change would require legislation.

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*/ The SIA is apparently also concerned that the Commission will revoke confidential treatment which it has granted to risk arbitrage positions disclosed pursuant to Section 13(f). I think this is highly unlikely.

6. 1934 Act Section 16(a)

I agree with this proposal, although it does not require legislation and seems rather trivial for Task Group consideration.

The SIA suggests that Section 16(a) of the Securities Exchange Act -- which pertains to disclosure by (among others) those owning in excess of 10 percent of an issuer's securities and to such persons' short-swing trading profits -- should not apply to broker-dealers engaged in block trading and "bought deal" transactions. Exempting these categories of 10 percent ownership from Section 16 would, in my view, be fully consistent with the purposes of the Section.

The Commission has clear authority to implement this change administratively. I do not agree with the SIA that the Act should be amended in this regard; Commission rulemaking would be fully adequate.

7. The Securities Investor Protection Act

This idea seems an excellent one for Task Group review, although it should be appreciated that the proposal would likely be controversial because SIPC opposes it.

I agree that SIPC should be amended in order to afford the SIPC trustee the flexibility to continue to operate a broker-dealer during the process of liquidation -- at least to the extent of accepting buy and sell orders from customers, where necessary to protect them from financial injury. While SIPC might not choose to implement this authority in most cases, I can see no harm in affording it the option to do so. I understand, however, that SIPC opposes this recommendation. The Commission's Division of Market Regulation is now studying the issue and will report to the Commission concerning it.

Implementation of this proposal would require legislation.

8. Employee Retirement Income Security Act of 1974

It would be inappropriate for the Commission to make any type of recommendation concerning these matters to the Bush Task Group.

The SIA's recommendations in this area deal exclusively with a statute -- ERISA -- and rules thereunder administered by the Department of Labor. I currently lack the basis for any

informed opinion concerning these suggestions. I have asked the Counselling Group to prepare a comprehensive analysis of ERISA and the problems it raises, including those cited by the SIA. I anticipate, however, that it will take some time to complete this study, since ERISA is a highly complex statute.

It appears that most of the SIA's recommendations would require legislation, although certain of them could be implemented by the Department of Labor administratively.

9. Investment Company Act Section 12(d)(3)

I agree with this proposal, although it does not require legislation and seems rather trivial for Task Group consideration.

The SIA recommends that investment companies be permitted to acquire shares of broker-dealers. Section 12(d)(3) currently prohibits such purchases. The Commission has authority to adopt exemptive rules under the Investment Company Act, and it seems to me that such a modification to the existing statutory prohibition would be appropriate. The Commission should not, however, permit funds to acquire shares of affiliated broker-dealers.

This proposal could be implemented through Commission rulemaking.

10. Prospectus Delivery

I agree with this proposal, although it does not require legislation and seems rather trivial for Task Group consideration.

I agree with the general thrust of the SIA's suggestion that broker-dealers be permitted to confirm sales of new issues by companies registered on Forms S-2 or S-3, and Form S-1 syndicate trades, without simultaneously transmitting the prospectus; the prospectus would be mailed to the customer separately. The Division of Corporation Finance is currently working with the NASD on implementing a similar proposal.

This proposal could be implemented through Commission rulemaking.

11. Accelerated Offerings, Rule 415 and Underwriters' Liability

I recommend against encouraging the Bush Task Group to involve itself with these issues.

The SIA recommends the Commission promulgate a rule which would limit the exposure of underwriters to Securities Act Section 11 liability in integrated offerings. The SIA's recommendation would reduce underwriter exposure by eliminating due diligence responsibility for incorporated documents or by adopting a "safe harbor" defining due diligence procedures. These are complicated and much-discussed proposals which would be highly controversial with the Commission and the Congress. Since Commission support for such a proposal is far from certain, the Task Group might expose itself to embarassment if it were to recommend them, and then encounter Commission opposition.

The SIA's proposal could be implemented through Commission rulemaking. Because of the great sensitivity of these ideas, however, should the Commission determine to make recommendations in this area, legislation might be the wiser course.

Attachments

Tab A -- OGC staff memorandum

Tab B -- OGC staff memorandum concerning the pros and cons of arbitration

Tab C -- SIA August 3 letter

Tab D -- Richard C. Breeden's August 8, 1983 letter to Chairman Shad and Chairman Shad's August 19, 1983 memorandum to Dan Goelzer

cc: John Daniels