

COMMENTS OF THE SECURITIES AND EXCHANGE COMMISSION ON S. 2058  
TO THE SUBCOMMITTEE ON SECURITIES OF THE SENATE COMMITTEE ON  
BANKING, HOUSING AND URBAN AFFAIRS, 93RD CONGRESS, 1ST SESSION  
(1973)

Our comments on specific provisions of S. 2058 are  
as follows:

Section 3

Section 3 of the bill would amend Section 3(a) of the Exchange Act by adding definitions of the terms "clearing agency," "participant," "transfer agent," "appropriate regulatory agency" and "rules of a clearing agency." We note that there are certain exclusions from the terms "clearing agency," and "transfer agent." In this connection, we wish to note that investment company shares (e.g., mutual fund shares) are frequently distributed through methods involving the use of intermediary organizations commonly referred to as "service agents." The functions performed by such agents, acting in various capacities simultaneously for investors, retailing dealers, principal underwriters and issuing investment companies, may vary somewhat throughout the industry, but generally these functions include the following:

1. Receive orders accompanied by payment, directly from shareholders for the purchase of fund shares.

2. Compute the portions of the investor's payment due to the fund, the underwriter, and the retailing dealer, record the transaction accordingly, and credit the monies to the appropriate accounts.
3. Credit the share account of the investor with the number of shares purchased.
4. Mail a confirmation statement of the transaction to the investor, the retailing dealer and the registered representative of the retailing dealer. Copies are usually also furnished to the principal underwriter, the fund custodian and the fund for their records.
5. Process orders for the liquidation of fund shares.
6. Calculate and process the reinvestment of cash dividends for shareholders.

Depending on the nature of the services rendered, most of these service agents appear to come within the definition of the terms "clearing agency," and "transfer agent" as defined in Section 3. In this connection, we note that the last sentence of proposed paragraph (22) and the last sentence of proposed paragraph (24) of Section 3(a) would contain certain exclusions from the terms "clearing agency," and "transfer agents." We assume that these exclusions do not refer to service agents who perform these functions in connection with mutual fund shares or variable annuity contracts. We suggest that the exclusionary sentence in proposed paragraph (24) be amended to make this clear.

Section 4

Section 4 would amend Section 15(c) of the Exchange Act by adding a new paragraph (6) to make clear that the Commission has authority to adopt rules applicable to brokers and dealers regulating the time and method of making settlement, payments and deliveries, and opening, maintaining and closing accounts. We believe the only meaningful reading of this Section and the parenthetical phrase "other than an exempted security or commercial paper, bankers' acceptances or commercial bills" is that a broker or dealer whose business is entirely in exempted securities would not be subject to rules adopted pursuant to proposed Section 15(c)(6), but that a broker or dealer who engages in transactions in both exempted and nonexempted securities would be subject to the full effect of all the rules under this Section. We recommend that this be made clear in the legislation.

Section 5

Proposed Section 17A(c) would require the Commission to find, as a prerequisite to registration, that a clearing agency meets the criteria set forth in that Section. We note

that proposed Section 17A(c)(2) would, among other things, give a clearing agency discretionary authority to deny participation to persons who have been expelled or suspended by a registered clearing agency during the period of such expulsion or suspension. The Commission believes that its approval should be obtained before a person currently under suspension or expulsion from a clearing agency may become a member of another clearing agency.

Proposed Section 17A(d) would require the Commission to publish notice of the filing of the registration statement of a clearing agency and afford interested persons an opportunity for comment. Within 60 days of filing of a registration statement by a clearing agency, the Commission would be required by order to grant such registration or institute appropriate administrative action to determine whether the application should be denied.<sup>1/</sup> The Commission does not object to a requirement that it institute administrative action to determine whether applications for registration

---

<sup>1/</sup>The sixty day period within which the Commission is required to act with regard to clearing agencies is unduly short in view of the fact that the notice of filing must be sent out for public comment. Since the Commission must prepare a release announcing the filing, await comments on the filing, and analyze these comments, we suggest that the Commission be allowed 120 days to act in the case of clearing agencies.

should be denied, if the intent of the proposed amendment is, as we believe, to require due process when denial of registration is being considered and the defect in the registration statement cannot be remedied.

Proposed Section 17A(1)(1) would grant the appropriate regulatory agency direct disciplinary power over clearing agencies, and proposed Section 17A(1)(2) would grant the appropriate regulatory agency direct disciplinary power over participants. Proposed Section 17A(1)(3) would give the appropriate regulatory agency authority to remove from office any officer or director of a clearing agency or securities depository who has willfully abused his authority.

Where the Commission is the appropriate regulatory agency, we suggest the following. In Subsection (1)(2) of proposed Section 17A the Commission should be granted direct authority to censure or otherwise impose limitations on a participant. The rather severe sanctions of expulsion or suspension may work an undue hardship on the participant, and the additional sanctions suggested above will give the Commission greater administrative flexibility to fashion appropriate remedies. In addition, we believe that Section (1)(2) of proposed Section 17A should not authorize the Commission to discipline a participant for violation of a

clearing agency rule which relates solely to internal management or procedures between a clearing agency and its members when such violations do not affect the public interest, the interests of investors or the efficient processing of securities transactions. We also believe that under this Section the Commission should not be required to proceed against any clearing agency participant on the basis of violations of clearing agency rules without first notifying the clearing agency of the alleged violations and the Commission's intention to institute a proceeding based on it, and giving such clearing agency a reasonable time within which to take appropriate action. However, the Commission makes no judgment as to whether similar additional sanctions or procedures would be reasonable for the appropriate bank regulatory authorities regarding entities subject to their regulatory jurisdiction.

In Commissioner Evans' statement with respect to the bill, he pointed out that the Commission could not discharge its functions under the bill, particularly with respect to rulemaking, in an informed manner unless it had authority to review the operations of clearing agencies. Such review would be solely in aid of the Commission's functions and not for enforcement or compliance purposes. The Committee's staff

suggested that the Commission submit a draft of statutory language to accomplish this purpose. We accordingly suggest that paragraph (p) of proposed Section 17A be amended by inserting the following at page 21, line 8 of the bill, in lieu of the provisions of that paragraph commencing with the words "Nothing in this section . . . ."

"Whenever the Commission is considering a rulemaking or other proposal regarding clearing agencies, after submitting a copy of said proposal to each of the other appropriate regulatory agencies, if the Commission determines that in addition to consultation with and the receipt of views from the other appropriate regulatory agencies, it is necessary to review the operations and related activities of a clearing agency or agencies, upon notice to the appropriate regulatory agency for the person involved, the Commission may conduct such reviews as it deems necessary to fulfill its responsibilities under this Section.

The Commission and the other appropriate regulatory agencies shall coordinate their examinations and reviews in order to minimize unnecessary duplications.

Nothing in this Section shall impair the examination powers of the Commission with regard to persons for which it is the appropriate regulatory agency or the authority of any state banking authority or other state or Federal regulatory authority having jurisdiction over a person registered as a clearing agency from making or enforcing rules governing such person which are not inconsistent with this Section or any rules or regulations promulgated hereunder."

Similar language should be inserted for transfer agents in proposed Section 17B at the end of paragraph (k), on page 29 of the bill.

Section 6

Proposed Subsection 17B(a)(3) would make clear that the provisions of Section 17B shall apply only to securities which are registered pursuant to Section 12 of the Exchange Act, or which would be required to be so registered except for the exemption provided in Subsections (g)(2)(B) or (g)(2)(G) of Section 12 and persons performing the function of transfer agents with respect to securities. Proposed Section 17B would not apply to variable annuity contracts issued by insurance companies. The last sentence of proposed Subsection 17B(a)(3) should be revised to make clear that service agents who may perform transfer agent functions in connection with variable annuity contracts would be subject to the requirements of Section 17B.

Proposed Subsection 17B(i) regarding compliance with the requirements of proposed Section 17B by the appropriate regulatory agencies other than the Commission, indicates that a non-bank subsidiary of a bank holding company shall be considered a bank. In his statement of July 11, 1973,

Commissioner John R. Evans recommended that the Commission be the appropriate regulatory agency for all non-bank subsidiaries of bank holding companies which are either depositories, clearing agents or transfer agents. We again strongly endorse this recommendation.