

MEMO# 2273

October 23, 1990

FEDERAL SECURITIES BILLS BECOME LAW

October 23, 1990 TO: BOARD OF GOVERNORS NO. 77-90 CLOSED-END FUND MEMBERS NO. 42-90 INVESTMENT ADVISER MEMBERS NO. 50-90 INVESTMENT ADVISER ASSOCIATE MEMBERS NO. 45-90 SEC RULES MEMBERS NO. 72-90 RE: FEDERAL SECURITIES BILLS BECOME LAW _____ Last week,

President Bush signed into law two major federal securities bills, the "Market Reform Act of 1990" and the "Securities Enforcement Remedies and Penny Stock Reform Act of 1990". The main provisions of each bill are summarized below. Market Reform Act of 1990 The Market Reform Act, originally inspired by the October 1987 market break, is intended to enhance the SEC's oversight of the securities markets and participants in those markets. The legislation gives the SEC emergency authority to halt trading on a securities exchange, after notifying the President. Previously, only the President could order a trading halt. The legislation also authorizes the SEC to adopt rules that would enable the SEC to restrict various practices such as program trading during periods of extraordinary market volatility. Other provisions of the legislation authorize the SEC to impose reporting requirements on certain large traders to enable the SEC to monitor their activities. The legislation also includes risk assessment provisions that authorize the SEC to adopt recordkeeping and reporting requirements for registered broker-dealers with respect to the activities and financial status of certain associated persons. The Institute supported an exemption from this provision for any registered broker-dealer primarily engaged in mutual fund underwriting, on the theory that the failure of such a broker-dealer would not have a material adverse effect on the securities markets as a whole. In this regard, the report of the House Committee on Energy and Commerce on the bill specifically recognizes that "[s]ome financial and securities activities, such as ... mutual fund distribution, involve lower degrees of risk and a lower probability that financial problems will adversely affect the broker-dealer." Additionally, the final version of the legislation authorizes the SEC to grant exemptions based on consideration of several factors, including "the nature and extent of the regulated person's securities activities." The Market Reform Act contains provisions intended to strengthen the clearance and settlement systems for securities, options and futures; provides for coordination between the SEC and banking regulators with respect to risks to broker-dealers; and requires the SEC, the Treasury Department, the Federal Reserve Board and the Commodity Futures Trading Commission to report annually to Congress on the status of their efforts to coordinate regulatory activities and to protect the markets. Securities Enforcement Remedies and Penny Stock Reform Act of 1990 The Securities Enforcement Remedies and Penny Stock Reform Act significantly expands the SEC's enforcement powers. It enables the SEC to ask a federal district court to impose money penalties in civil actions involving violations of the federal securities laws. The maximum penalties allowed range from \$5,000 to \$100,000 for an individual, and from

\$50,000 to \$500,000 for a corporation, depending on the egregiousness of the offense. The court also would have discretion to bar persons from serving as officers or directors of reporting companies. The applicable standard for such a bar is that the person has demonstrated "substantial unfitness to serve" as an officer or director. The legislation gives the SEC authority to impose both temporary and permanent cease-and-desist orders under certain circumstances. Other provisions authorize the SEC to assess civil money penalties in administrative proceedings involving willful violations of the federal securities laws or for failure to supervise another person who has committed such a violation. The maximum penalties are the same as those described above. The legislation sets forth certain factors that the SEC may consider in determining the appropriate amount of any penalty. The SEC also is authorized to order an accounting and disgorgement. When the legislation was proposed, the Institute expressed concern to the SEC staff about authorizing the SEC to assess penalties against registered investment companies. The concern was that this could have the effect of penalizing shareholders for the wrongful behavior of responsible individuals, such as an investment adviser. This concern is addressed in the Senate Banking Committee's report on the legislation, which indicates that the Committee does not normally expect the SEC to seek penalties against registered investment companies. Rather, penalties generally will be assessed against responsible individuals. The final version of the legislation also includes provisions intended to address penny stock fraud. Among other things, it requires development of an automated quotation system for penny stocks, and authorizes the SEC to adopt rules restricting blank check offerings and requiring brokers and dealers to provide additional information to customers with respect to penny stock transactions. In response to the Institute's request, the definition of "penny stock" specifically excludes securities issued by a registered investment company. Frances M. Stadler Assistant General Counsel