

MEMO# 2785

May 23, 1991

CONGRESS CONSIDERING AMENDMENTS TO SECTION 11(A) OF THE SECURITIES EXCHANGE ACT

May 23, 1991 TO: CLOSED-END FUND COMMITTEE NO. 11-91 SEC RULES COMMITTEE NO. 29-91 RE: CONGRESS CONSIDERING AMENDMENTS TO SECTION 11(a) OF THE SECURITIES EXCHANGE ACT _____ The

Subcommittee on Telecommunications and Finance of the House Committee on Energy and Commerce recently held a hearing to consider possible amendments to Section 11(a) of the Securities Exchange Act. Legislation to this effect was introduced in the Senate earlier this year. Copies of that bill (S.577) and supporting commentary are attached. The amendments would remove the provision making it unlawful for any member of a national securities exchange to effect any transaction on such an exchange for an account with respect to which such member or an associated person exercises investment discretion. Currently, Rule 11a2-2(T), which was adopted by the Securities and Exchange Commission in 1978, provides a partial exemption permitting exchange members to handle orders for affiliated managed accounts provided that, among other things, trades are executed by an unaffiliated broker. Thus, the practical effect of Section 11(a) is that exchange members may effect transactions for their managed accounts so long as trades are executed on the exchange by an unaffiliated floor broker. The proposed amendments would remove the requirement that an unaffiliated floor broker be used to execute these trades. The proposed amendments are supported by the Securities and Exchange Commission on the grounds that they would facilitate more efficient execution of fund portfolio transactions at a lower cost. One question that has been raised by some investment advisers in connection with this legislation is whether it would create an affirmative obligation on the part of advisers to form a broker-dealer affiliate for the purpose of executing portfolio transactions. SEC Commissioner Roberts, in his testimony before the Telecommunications and Finance Subcommittee, stated that given the exemption contained in Rule 11a2-2(T), "the elimination of the managed account provision would seem to have, at most, a marginal impact on the investment advisers' fiduciary responsibilities concerning use of affiliated broker-dealers." Commissioner Roberts noted that "Obtaining the lowest possible commission rate is only one factor in determining whether a fiduciary has met its duty of best execution." As set forth in S.577, the proposed amendments give the SEC authority to adopt rules requiring as a condition to the ability to effect transactions for an affiliated managed account that an exchange member (1) obtain written authorization to effect transactions on an exchange for an account managed by the member or an affiliate thereof, and (2) furnish the authorizing person with an annual statement disclosing the aggregate compensation received by the exchange member for effecting such transactions. Similar conditions currently apply under Rule 11a2-2(T), in the case of transactions where

the initiating member or an associated person retains any compensation. The fact that the amendments are supported by the SEC is expected to enhance the likelihood of its eventual enactment. We will keep you informed on the progress of this proposed legislation.

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