Electronic Shares and Roll-Ups: Some Past Opinions Revisited

By James B. Cloonan

Last November, my column covered the overhaul of the current clearance and settlement system for securities, and the impact it will have on individual investors.

As expected, the discussion concerning the move to "book-entry" or "certificateless" security ownership generated the most comment. I received several letters from individuals expressing their concern about leaving shares with brokers.

Certificateless trading does not necessarily imply that shares must be left with a broker, and I believe it is quite possible to address the concerns of these investors while at the same time moving forward with technology.

A Letter to the SEC

I forwarded my position to Richard Breeden, chairman of the Securities and Exchange Commission. The letter follows:

"Dear Mr. Breeden:

"On behalf of the 100,000 members of the American Association of Individual Investors, I would like to express what I feel is our members' feelings about the proposed 'book-entry' system of recording share ownership.

"Our members are serious and substantial individual investors, a large number of whom use personal computers and recognize that we are in the electronic age. Based on discussion with members and our own research into the matter, we feel it is essential that the move to book entry provide the following options for the individual:

"Option 1: Electronic shares (book-entry form) held by the broker in street name. This is for those individuals having margin accounts, or wanting to leave shares with the broker to take advantage of special brokerage services.

"Option 2: Electronic shares registered in the individual's name but left in the database of the issuing corporation or a national depository agent. This would permit individuals to sell shares through any broker and would relieve anxiety about being tied to a particular broker or about problems in the case of brokerage failure (even with SIPC).

"Option 3: Issuance and delivery of share certificates to the individual. This existing procedure would make a certain percentage of investors feel more secure. In the long term, those individuals actually requesting delivery would approach the small number exercising this option with mutual funds. The existence of the option, however, would not only serve those using it, but provide a feeling of confidence to many others.

"I understand that the Commission will be having meetings with the Group of Thirty and others in the near future. I would appreciate it if our views could be presented as part of the public record of the meetings."

More on Limited Partnership Roll-ups

I have also heard from many members about bad experiences with partnership roll-ups—combining a number of limited partnerships into one master partnership. While legislation concerning roll-ups is pending, it might take some time for it to pass. In the meantime, what should investors do?

In my opinion, no investor should buy public limited partnership interests unless the partnership agreement:

- Requires 80% of the limited partners to approve any merger, combining or conversion to a corporate form; or
- Permits those limited partners opposing any change in structure to retain the original arrangement.

James B. Cloonan is president of AAII. His column is his own opinion and does not necessarily reflect the views of the AAII Journal.