REMARKS OF

RICHARD C. BREEDEN, CHAIRMAN
U.S. SECURITIES AND EXCHANGE COMMISSION

INSTITUTE OF INTERNATIONAL BANKERS
NEW YORK, NEW YORK

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It is a very great pleasure for me to be able to join the Institute of International Bankers at your 26th Annual Dinner. I must confess that for a humble securities regulator this is an awesome sight. Indeed, this many bankers have probably not been gathered together since the last meeting of the Olympia & York creditors committee. Just think, if each of us here took only a million square feet of space, Canary Wharf could actually be fully leased.

Actually, it is refreshing to be able to escape Washington for a bit during this year of a Presidential election. As you all know, Ross Perot has really upset the normal political calculations of a two party race. All of Washington is now abuzz with the hottest issue of all -- whom Mr. Perot will select as his running mate. Since Mr. Perot plans to make televised "electronic town meetings" a nightly part of his Administration, how about Vice President ... Ed McMahon.

Actually, the news media has been too harsh on Mr. Perot for the idea of televised programs to solve our critical national

problems like the crushing budget deficit. Personally, I like the idea. Just imagine, we all tune in to decide how to solve the federal deficit, and the program is slotted in just after "Jeopardy!" and immediately before "Lets Make a Deal." If that is successful, we could tackle Middle East policy after a rerun of "Lawrence of Arabia."

Of course, the Presidential race isn't the only thing going on in Washington this year. Congress has had its problems too. With the Congressional leadership trying to look more professional, I understand that the U.S. House of Representatives has applied for affiliate member status in the Institute of International Bankers. Larry Uhlick told me that the application was all set to be approved, but -- you guessed it -- the check for the application fee bounced.

Of course at the SEC, we stay out of politics, and concentrate on the job of regulating the largest and most dynamic securities market in the world. Last year was certainly busy, with over $700 billion in financings, including over 300 initial public offerings, and the Salomon Brothers problem in the government bond market. During the year, we also had to work with the securities industry on many specific problems and issues that inevitably arise, including more than a few complaints about our rules.

Indeed, the job of a regulator often reminds me of the

medieval order of monks in France that observed a vow of absolute and complete silence, except that once a year each monk could utter exactly two words to the Abbott. One of the new monks came to the Abbey and worked throughout the year toiling under the hot sun in the vineyards. He gave enormous thought for months to his upcoming meeting with the Abbott. When the big day arrived, the monk looked at the Abbott and said:

"Bad Food."

At the end of the monk's second year, he approached the Abbott and said:

"No Women."

Throughout the next twelve months of backbreaking labor, the monk thought about his next meeting with the Abbott. When it came, he said:

"Hard Bed."

Finally, at the end of the fourth year the monk came before the Abbott, looked him straight in the eye and said:

"Going Home."

In response, the Abbott looked at the monk and said:

"Good. You haven't stopped complaining since you got here."

Well, I would like to take a few minutes to reflect on a few current issues arising out of developments in world capital markets. For the past generation, securities markets worldwide have experienced far-reaching technological change.

TECHNOLOGICAL CHANGE

Twenty years ago the NASDAQ was a tiny and relatively insignificant upstart in trading in the U.S., and both New York and London had physical trading floors. Average daily trading volumes were under 20 million shares for the NYSE and NASDAQ. That compares with around 200 million shares per day today for both the NYSE and NASDAQ.

More important than volume alone, trades were both initiated and recorded largely by hand twenty years ago. Computers were coming into the marketplace, but there was nothing like today's capacity for computer directed trading -- often to take advantage of relatively small disparities in price between relatable securities or derivatives for a firm's own account.

Today's trading market is not only larger and faster, but also much more complex. The vast array of on and off-balance sheet derivatives of all kinds, including swaps, forwards, index options, index warrants, index futures and so on, has made our trading market "multi-dimensional". Today the mere identification of

whether a firm is long or short can be difficult, and quantification of aggregate risk profiles is a major problem.

Technology has also expanded markets around the world and around the clock. "After hours" systems in the U.S. have proliferated to include Instinet, Posit, Wunsch, "Crossing session I", "Crossing session II", International NASDAQ, and many others.

Technologically it is now possible --though not necessarily desirable -- to eliminate all physical trading floors. Among other things we are grappling with the issue of whether in the future there should be any regulatory requirements to encourage liquidity in a central or core marketplace, or whether market participants should be allowed to create an infinite number of overlapping electronic systems. Technical reliability, transaction costs, market access, quotation and transaction reporting, surveillance capabilities and investor protection concerns are all issues that have to be considered in evaluating new trading systems, together with the basic issue of "market fragmentation." To some, public policy ought to promote market concentration to maximize liquidity. To others, public policy ought to allow innovation and diversification to maximize competition.

INTERNATIONAL SECURITIES OFFERINGS

Among the other changes, our market has surely become an

"international market", with issuers more and more frequently raising capital in multiple markets simultaneously. Increasingly, investors in almost every country are acquiring securities of foreign companies, and major market participants now operate in all the major capital market centers around the world. Just today the first Brazilian company to be publicly traded in the U.S. -- Aracruz Celulose -- had its registration go effective and commenced trading on the New York Stock Exchange.

The list of foreign companies that have filed registration statements to conduct public offerings in the U.S. public market just since April 1, 1992 is quite extensive:

Skandinaviska Enskildabanken (Sweden)
Boral Limited (Australia)
Edusoft Ltd. (Israel)
Rogers Cantel Mobile Inc. (obligor)/Rogers Cantel Inc. and other subsidiaries (guarantor) (Canada)
Bone Health Inc. (Canada)
International Petroleum Corp. (Canada)
Artagraph Reproduction Technology (Canada)
Palmer Tube Mills Ltd. (Australia)
Elfron Electronics Industries Ltd. (Israel)
Hafslund Nycomed AS (Norway)
Korea Electric Power Corporation (Korea)
Grupo Simec, S.A. de C.V. (Mexico)
Norsk Hydro a.s. (Norway)
British Bio-technology Group plc (UK)
Transportacion Maritima Mexicana, S.A. de C.V. (Mexico)
Van Diemens Co. Ltd. (Bermuda)
Telefonos de Mexico (Mexico)
Alcatel Alsthom (France)
Biochem Pharma Inc. (Canada)
Cantab Pharmaceuticals PLC (UK)
Sapiens International Corp. N.V. (Netherlands Antilles)
Societe Nationale Elf Aquitaine (France)
Alcan Aluminum Limited (Canada)
Nova Corp. (Canada)
Teck Corp. (Canada)
Cabre Exploration Ltd. (Canada)
Canadian Pacific Ltd. (Canada)

Bell Canada (Canada)
Canadian Pacific Forest Products Ltd. (Canada)

Of course from my perspective there has never been a better time for foreign companies to offer securities in the U.S. market. Our market is providing huge amounts of capital at very strong prices for issuers -- G.M.'s recent $2.1 billion offering of common stock is certainly a prominent example. Investor interest in foreign offerings has also been growing significantly. Fifty-three foreign companies were listed in the U.S. public market for the first time since January 1, 1991, and overall there have been more than 150 U.S. public offerings by foreign companies in this time. Those companies that are still sitting on the sidelines during this market are, quite frankly, in danger of missing the (capital) boat.

In addition to the favorable market climate, the regulatory approach of the SEC to foreign offerings has never been more flexible. We have already proposed -- and will shortly complete -- rules to allow use of foreign documents for many rights offerings, exchange offers and tender offers by foreign issuers. We created the Rule 144A trading market, in which over 150 offerings raising more than $15 billion have been completed in under 2 years -- many by foreign issuers. We will soon be proposing rule changes to add institutions with around $1 trillion in assets to the qualified buyers in that market.

Of course with respect to the issue of offerings in the retail public market, we still require that foreign issuers play by the same rules as U.S. issuers. There we want U.S. investors to be able to compare the earnings and financial condition of both U.S. companies like Ford, G.M. or Boeing, and foreign issuers like Volvo, Honda or British Aerospace. The current system lets investors compare financial data directly, as well as avoiding significant preferences for foreign firms over our own.

Notwithstanding our general approach of equal, national treatment, we have made numerous accommodations expressly for foreign issuers. We abolished quarterly reports by foreign companies in 1987, and we have modified accounting or disclosure rules for specific issuers very frequently. Something we are doing must be working, because the total number of new foreign companies traded in the U.S. public market is up by over 130% since 1983, compared with an increase of only 17% in the London market even with the effects of EC '92.

Some propose total reciprocity in accounting and disclosure requirements with any country, no matter how low its own standards of investor protection. That type of blanket abolition of U.S. rules is not an attractive option compared with the more targeted policy of flexibility that we have been pursuing. However, we will continue to work to make the process of offerings by foreign companies less complex and costly than it is today -- as we are

also trying to do for domestic small businesses. We expect to continue working directly with the U.S. exchanges and the NASD to address constructively this important issue while maintaining the essential principles of full public disclosure of material information and protecting investors against insider trading and other forms of fraud.

CAPITAL RULES

Another important international regulatory question is the issue of leverage and development of better capital standards for banks and securities firms. After watching the severe deflation in prices in the Japanese securities market and commercial real estate markets around the world, the importance of realistic capital standards for market stability should be evident. Indeed, in the case of Japan, with both securities losses amounting to around $2 trillion, and as yet undisclosed losses in domestic commercial real estate, the aggregate loss could approach the entire value of the U.S. securities market.

The first lesson in avoiding severe deflation of values is, of course, to avoid having an inflation of asset values driven by a speculative bubble, market manipultation, government subsidies or other non-market forces. In part to help avoid excessive speculation, and certainly to help absorb losses, financial intermediaries and market participants must not be leveraged to an

excessive degree. Here the Basle Banking Committee's capital standards have helped to improve the fundamental stability of the world banking system through imposing global standards to control exessive levels of "credit risk". Similarly, tough capital standards, daily mark to market accounting and margin requirements in the U.S. securities markets have helped to control speculation and maintain overall market stability.

Though the Basle standards seem to have worked reasonably for credit risk, the decision to postpone developing the methodology for quantifying interest rate risk and imposing capital requirements against it seems unfortunate. While a Ginnie Mae or a principal only Treasury strip may not involve any default risk, none of us would characterize these as riskless instruments. However, the current rules require capital in significant quantities against the credit risk of loans but provide only weak overall leverage ratios to compensate for interest rate risk on government securities. As a result, there is an economic incentive for banks to substitute interest rate risk for credit risk.

In the U.S., banks have been doing exactly that on an enormous scale. Banks have been rapidly growing their securities portfolios, while their base of loans has been shrinking. Thus, in the year ended last January, aggregate commercial and industrial loans of U.S. banks fell by 4%, while their securities holdings rose 21%. Perhaps this is a coincidence, but it is more likely

that the capital incentives and the portfolio changes are related.

From my perspective, capital rules should be to prevent excessive leverage and encourage overall market stability, not to direct the most desirable mix of investments -- which should be a market decision. Thus, capital rules should be "neutral" as to investments with equivalent levels of risk, even if it is risk of a different type or nature. If a capital rule is not "market neutral", it will essentially function as an indirect system of credit allocation driven by the government. By creating an artificial incentive to invest in certain types of securities rather than to make loans, the current Basle standards seem to fail the test of market neutrality.

The second problem with ignoring interest rate risk is that in a system of complete and total government backing of risk through deposit insurance, the taxpayers may actually be underwriting unhealthy levels of risk in institutions that carry significantly mismatched positions. Indeed, even at their lowest point the U.S. savings and loans were required to maintain 3% capital against interest rate risk in their mortgage portfolios. Depending on a bank's volume of loans at 8% capital, some banks may actually hold significant portfolios of securities with a "zero" marginal capital requirement under the Basle formula. Under certain possible scenarios for interest rates and inflation, this could prove to be unfortunate.

None of us can say that our financial systems will not experience some choppy or even downright stormy weather over the years to come. Therefore, while we should not wish to impose unrealistically high capital requirements that would be economically inefficient, by the same token we cannot afford to build a system that is too brittle to absorb problems that are forseeable. We also cannot afford to allow markets to compete with each other for business on the basis of "competitive leverage". Thus, both banking and securities supervisors need to work together to develop capital standards that control, rather than simply channel, leverage.

To their credit, the international banking supervisors have recognized the issue of interest rate risk, and are working hard to develop new standards. For the last two years, the Basle Banking Committee and the the IOSCO Technical Committee have been working together to develop a common methodology for measuring risk in securities portfolios. This has been a complex and difficult international process, but we have made very solid progress. Hopefully by the end of this year we will have reached substantial agreement on a joint set of minimum international standards.

Whatever capital standards emerge from this joint process, they need to cover the entire portfolio of securities held by both banks and securities houses, not merely a partial selection. That

is necessary to make the rules work, and also to avoid creating a very strong incentive to "internalize" bank securities activities rather than to subsidiarize them. The latter requirement, which is of course the law here in the U.S., also represents in my view the better structural form of organization from the perspective of quantifying and addressing risk exposure. It is also essential, in the U.S., to prevent extension of taxpayer guarantees in the banking system to the entire securities market.

CLEARANCE AND SETTLEMENT

Another very important area of common concern should be improving the clearance and settlement systems in use worldwide for securities markets. Just yesterday I was presented with the final report of the "Bachmann Task Force" on reform of the U.S. clearance and settlement system. This group was organized at my request to design a specific roadmap for implementation of a conversion of U.S. settlement procedures from a T+5 to a T+3 format, and from next-day to same-day funds. These fundamental reforms could reduce an estimated 50-60% of the aggregate credit risk in the current system at very low cost.

From my perspective, it is time for the "processing" side of our system to start to catch up with the trading side. We may never have settlement in nanoseconds, like our trading, but we should still seek to eliminate as much unnecessary risk as

possible. To achieve this, the U.S. industry needs to get behind the effort to enhance the U.S. clearance system. While the specific steps in this Report deserve careful, though rapid, study, in the aggregate they set forth an industry blueprint for how to most sensibly achieve a very important enhancement to the safety of our overall marketplace.

Frankly, other reforms to the clearance system also need to be considered. In particular, I believe that it is time for the U.S. clearance agencies to look long and hard at the examples of Cedel, Euroclear, and ultimately, Taurus, concerning multicurrency settlement capability.

Whether the U.S. likes it or not, many investors in the future will think, and operate, in Ecus, as well as perhaps a few older currencies. A system that cannot accomodate multicurrency settlement will most likely create a significant competitive disadvantage for the overall national trading market. Thus, the U.S. clearance system needs to begin active study of the issues that would be created by providing multicurrency settlement of securities trades in the U.S.

BUDGET DEFICITS AND TAX INCENTIVES

Finally, though the hour is late and my welcome no doubt wearing thin, let me briefly mention one more subject, and that is

the challenge in the U.S. of vastly increasing the scale of public savings and investment and deploying those investment dollars into startup companies, small businesses and new facilities for established companies. For the past several years, the U.S. has been chronically underinvesting in our own economic future. As a percent of gnp, U.S. nonmilitary R&D has been approximately 1.9%, compared with 3% in Japan and 2.8% in Germany. Similarly, plant and equipment expenditures in the U.S. have not kept pace with other nations' efforts to modernize their manufacturing base.

Some suggest that the problem is "short term thinking", perhaps brought on by the collective joy of reading quarterly reports. I think that the U.S. tax code is a more likely candidate for reducing incentives for long term equity investing. Indeed, the total absence of relief from the double taxation of dividends creates a very strong tax punishment for equity investment, precisely the type of buffer to economic downturns that we need to accumulate, not discourage.

For too long the answer to a tax code that promotes leverage at the expense of financial stability has been that change would have a budget impact. That of course ignores the fact that creating an overleveraged economy that is more prone to recession can also have a negative budget impact. Similarly, I do not believe that it is economically sensible to tax the gain from interest on a Treasury bond at the same rate as a seed capital

investment in a small business early in its life cycle. There a zero capital gains tax rate might pay the economy a rich dividend in new technology and new jobs through private capital investment in the most innovative and vibrant sector of the economy.

This is not to argue that these tax reforms can be pursued without considering the deficit. Indeed, for too long we have been stalemated with a divided government in Washington unable to face up to the budgetary imperative of our times --- cutting federal spending in a massive fashion. The American government's financial house is not now in order, and it should be. There is plenty of blame to go around for that, but what is more important than assigning blame is finding the will to change.

CONCLUSION

More than at any other time in modern history, we have linked our respective economic fortunes together internationally through a system of open international trade and globalization of many basic markets. Certainly the world's capital markets are becoming increasingly linked to one another in a fashion that can help us mobilize capital on a world scale to provide financing for economic growth in the most efficient possible manner. As this system evolves, we must work hard to build the framework of oversight of these markets, so that the gains in efficiency are not offset either by greater instability or a greater vulnerability to abusive

conduct that is either unethical or unlawful. The problems of BCCI, Salomon and the scandals in Japan should underline the importance of finding effective international systems for policing abuse in the markets.

This evolving market will force changes in national laws and market practices around the world in the next decade, as it did in the last. On the other hand, "internationalization" cannot and should not be equated with a race to the bottom to achieve the lowest common denominator of investor protection, disclosure or market integrity. Harmonization ten years ago would have meant worldwide tolerance of insider trading. Today, the community of nations has largely proscribed insider trading. Indeed, a few countries even define it.

My point is a simple one. Our capital markets have developed powerful technological tools that have created many new opportunities for lowering the cost or improving the availability of capital. These same tools have also made it easier to pyramid risk on top of risk, and to create global exposures that disregard product markets, industry lines and national borders. Most major markets around the world are both open and competitive. At the same time, bankers and securities firms and the respective oversight bodies need to commit themselves to preserving certain essential values in that marketplace. Those include honesty, integrity, solvency and prudence. Judging by the momentous political and

economic events during the first two years of this decade, those virtues have not outlived their usefulness.

Thank You.