REMARKS OF

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

AMERICAN STOCK EXCHANGE PERSPECTIVES CONFERENCE

WASHINGTON, D.C.

NOVEMBER 4, 1992

U. S. Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

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As Heraclitus said, almost 2500 years ago, "nothing is permanent but change." Yesterday, Americans exercised the sovereignty of the people and chose to replace their elected government. Only one week ago, Canadian voters rejected far-reaching proposed Constitutional changes. In Europe, Denmark has said "no," France has said "yes," slightly, and others still have to decide on Maastricht. The tragedy of Yugoslavia's disintegration, and the ongoing process of change in the former Soviet Union, remind us of the uncertainty that affects the world's political systems.

Uncertainty is also widespread in economic affairs. The sudden unraveling of the ERM in Europe, the enormous decline in Japanese stock and land prices, the inability to achieve a GATT agreement, the unseating of the Chairman of General Motors and many other situations demonstrate that changes that might once have seemed remote can become this evening's news. In many nations, strong economic growth has given way to much tougher times, and new forces that we don't fully understand seem to be at work.

Financial markets have been specializing in surprises for some time, and they can be good or bad surprises. Five years and two weeks ago, the Dow Jones Industrial Average plunged more than 22% in a single day. Black Monday witnessed a surge of trading volume at unprecedented levels, stressing our trading and clearance systems to the limit. Afterwards, many people predicted that investors would abandon the market. However, there are today more than 20 million more investors in stocks in the U.S. than there were in 1980.

Even more dramatic has been the upsurge of financing volumes since Black Monday. During 1987, there were public offerings in the U.S. totalling $272 billion. Despite the crash in 1987 and the "crashette" in 1989, last year the volume of public offerings rose to $600 billion. If the pace of the first three quarters holds for the rest of the year, we will have more than $900 billion in public offerings in 1992, and our first $1 trillion year for securities offerings counting private placements.

For more than three years, I have had the privilege of leading the 2,600 men and women of the SEC. They have the task of examining almost 30,000 entities, and overseeing trading markets with roughly 1/2 of the world's total equity trading volume, and trillions of dollars in assets. They also have the job of detecting and then prosecuting in the courts frauds, market manipulations and other abuses of customers. Our regulatory

programs seek to protect customers, to promote market stability and integrity and to facilitate the capital formation process.

In carrying out those various responsibilities, the SEC has accumulated quite a bit of experience. We have lived through the Black Mondays, the Drexel Burnhams, the Ivan Boeskys, the Equity Fundings. Every year we oversee thousands of individual offerings that present almost every imaginable accounting or disclosure issue. Of course that doesn't mean that we have all the answers. Indeed, every day brings new types of frauds, new financial instruments, and new types of risk to be considered.

In addition, our market has become internationalized. In the past three years almost 150 foreign companies have made their first public offering of securities in the U.S., registering almost $62 billion in securities. Overall, more than 500 foreign reporting companies from 35 countries are listed for trading in the U.S. public markets. Each of these companies has different accounting and disclosure principles at home that are "reconciled," or "translated" into what their home country results would look like if they reported under U.S. generally accepted accounting principles. At some marginal cost to issuers, this translation into English, in a way, makes sure that American investors are not presented with a financial Tower of Babel in selecting among the U.S. companies and all the foreign firms in deciding where to invest their retirement nest egg, for example.

Of course we give all the foreign companies listing their stocks in America the same rights we give American companies. They don't get better treatment than the home team, or worse. Indeed, this year the Toronto Blue Jays proved that you don't have to be an American team to win the World Series. Maybe in the future it will be the Seibu Tigers -- though I would prefer the Baltimore Orioles. However, it is a simple proposition that if you want to play the game, you have to expect that the umpire will give you four balls and three strikes, just like the home team.

The principle of equal national treatment -- some would call it a level playing field among U.S. and foreign issuers -- has been the cornerstone of open access for the U.S. securities market. Nearly every week a registration statement for a new foreign company issuing securities in the U.S. market goes effective. Nearly every week, a registration statement for an initial public offering ("IPO") by an American company -- usually an up-and-coming small business -- also goes effective. Our rules require that investors get information on essentially equal terms from both of these new competitors for the investor's dollar -- as well as from all of the existing publicly traded companies, foreign and domestic.

This system gives investors confidence to invest. That confidence among tens of millions of investors is what allows the

country with the lowest savings rate to have by far the largest and most liquid securities market. Every single one of the more than 12,000 companies that are publicly traded -- U.S. or foreign -- have a fundamental duty to investors, enforced by the SEC. That duty is to tell investors the truth about all material information concerning the company's financial condition. Whether the year was a stunning success, a colossal failure or a disappointing muddle, each of those companies has to report (every quarter for the Americans, once or twice a year for the foreigners) how they did. They can't tell investors what they hoped to earn, or what they might have earned, or even what they'd like tax collectors to think they earned. They have to tell how much they earned or lost, and they have to tell the truth.

For the past two years, we have heard increasingly strident demands from one country -- Germany -- that this system must be abolished. Americans must junk the system we have used for decades, abandon our dedication to openness, truthfulness and equality among issuers. Instead, Germany seeks a system they call "reciprocity," but what they really want is a preference. They seek the right to make public offerings in this country without disclosing the earnings of the company or complying with the rules that apply to every U.S. company as well as the companies from Canada, Mexico, Brazil, Chile, Israel, Japan, Korea, Britain, France, Spain, Italy, Denmark, Sweden and dozens more that are already listed here. Ford, GM, Chrysler, Volvo, Fiat and Honda all

should have to disclose their income, pension liabilities and other obligations. However, Mercedes and Volkswagen, for example, should be exempt from those rules.

This, we are told, is how they do it in Germany. In essence, they want to play baseball in America, but they want seven strikes, no umpire and a right to cancel the game any time they don't like the reaction of the crowd.

The heart of this dispute involves the use of what are called "hidden reserves" in German accounting. Under the hidden reserves system, a company can report the net income it would <u>like</u> to show, not what it really made. Withdrawals from an off-balance sheet slush fund are used to add to real earnings if they don't look good enough. Alternatively, if earnings look very good, income is taken out of real earnings and added to the slush fund.

Thus, with hidden reserves investors and creditors may be told that a company had a net profit of a billion marks. In reality, the company might have lost 5 billion or made 10 billion. The company officers, its bankers and a favored few know the truth, but the public investor does not know anything more than the company decides to tell. Since insider trading isn't yet illegal in Germany, this stark disparity in knowledge among market participants may not be a problem for law enforcement authorities

there. Nonetheless, the system is tantamount to institutionalized insider trading, something that is a crime under our laws.

Germany insists that American public investors -- schoolteachers in Illinois, farmers in Nebraska and millions more across the country should follow the maxim of "Trust us, you'll like it." Of course, presumably each of the other 35 countries whose companies already sell securities under U.S. standards would demand a similar right. The result would be the elimination of the fundamental standard of integrity of the U.S. market to suit the whims of large German companies, who alone in the world insist they must be able to tell investors something different than the truth. When the SEC told them that we would be happy to work with them to help meet U.S. standards as flexibly as possible, their response has been public calls in Germany and the European Community for "pressure" on the SEC. We must abandon our protection to investors to suit their demands, they say.

This is not a question of detail, and it is not a question of comity among nations. It is a matter of principles, and goes to the very heart of our belief that every public company must be prepared to tell the truth, not falsehoods, to its investors. Therefore, the American saying "Don't hold your breath" would be my advice to those who think pressure tactics will change our minds.

Obviously, before long I will be a former Chairman of the SEC, and this question will still be around. As has been true over the past two years, the five commissioners of the SEC will jointly decide on any shift in the SEC's existing rules. Some may hope that the rules will change -- and perhaps they will. However, from President Franklin D. Roosevelt to President George Bush, the SEC has stood for certain core principles in the protection of investors. Michael Milken didn't like it, and the treasurer of Volkswagen may not like it, but that isn't our concern. I suspect that President Bill Clinton's SEC will continue to see its mission the same way the SEC always has, and always should. Obviously, time will tell on that one.

Compared to the 1980s, the 1990s may prove to be a decade in which capital is relatively expensive. Japan and Germany, for example, given their different domestic problems, are unlikely to export as much capital in the next decade as they did in the last decade. Many other nations that previously did not seek capital in the international markets are likely to do so: not only the new nations of Eastern Europe and the former Soviet Union, but also in Latin America and Asia. Even in the European Community, companies that were state-owned in the 1970s and 1980s will be seeking capital in the markets in the 1990s following privatizations.

Almost the opposite trend is occurring on the capital supply side. There the enormous declines in real estate values in the United Kingdom, U.S. and Japan have eroded the net worth of many individual and corporate savers. Voracious government borrowing to fund massive public spending deficits around the world also eats up the pool of private savings. If I'm right, in the 1990s the demand side of the market will be relatively stronger, and the supply side relatively weaker, than was true in earlier decades. Thus, it should be a "buyer's market."

If this is so, we can expect investors worldwide to be both more internationalist <u>and</u> more selective. Investors are unlikely, as they survey their international opportunities, to invest heavily in markets that do not provide adequate investor protection. Therefore, securities <u>markets</u> that want to be competitive in the 1990s will need to focus hard on achieving quality for the investor.

Quality for investors means having rules against insider trading, manipulation and other forms of fraud, and actually enforcing those rules impartially. It also means good corporate disclosure, relevant and reliable financial reports and a legal system that consistently protects the complex rights of modern finanical instruments. It also means speedy, safe and inexpensive clearance and settlement systems, and transparent trading systems so investors can tell the quality of executions they are receiving.

All these factors and more go into producing quality markets for investors. In a competitive environment, that quality will weigh heavily in investing decisions.

Our new President will face many challenges in many areas. Harnessing change to positive ends will undoubtedly be a high priority. From a business perspective, the U.S. will have a chance in the 1990s to take advantage of the preoccupations of some of our major competitors to restore jobs and income to the United States. To take advantage of our opportunities we will have to be smart, and we will have to work hard. We will need to roll up our sleeves and get serious about capital formation, in any and every sensible way possible. That capital also needs to find its way into things that enhance productivity, like R&D or plant and equipment.

As the country with the world's largest and by far most liquid, innovative and efficient securities market, the U.S. should have a major advantage in facing a period of tightening capital availability. Investors all over the world will be able to be more selective, and that means that the protections offered by U.S. markets and U.S. corporate disclosures may be an increasing advantage. Change will come, and our job is to make sure that change occurs in sensible ways that maintain our principles <u>and</u> enhance our competitiveness.