Advanced Text

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Major Efforts and Issues at the SEC

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Good evening. It's a pleasure to be with you.

For those of you, who have never heard of the Securities and Exchange Commission, it is a small government agency, that was created after the 1929 crash to help protect investors and maintain fair and orderly markets.

America has today, by far the best securities markets the world has ever known - the broadest, the most active and efficient, and the fairest. The SEC's job is to help keep them that way, without imposing unnecessary burdens on the marketplace.

Tonight I would like to highlight some of the major efforts and issues at the SEC and then invite your comments and questions.

For the past four years, the SEC has been increasing investor protections and corporations' financing flexibility - and reducing unnecessary paperwork and other expenses, that are ultimately borne by investors.

Shelf Registrations

The integration of corporations' registration and reporting requirements and the shelf registration rule, have reduced corporations' paperwork and other expenses, for the benefit of their shareholders, by over a billion dollars per annum - without compromising public disclosures. These savings are principally a result of keener competition between underwriters, and between the institutional investors, which purchase the bulk of investment grade debt issues, whether under shelf or conventional offerings.

Institutional Book-Entry

Expansion of the institutional electronic book-entry delivery system - in lieu of the physical delivery of securities - is saving over $350 million per annum for the benefit of investors, who ultimately bear such costs.

Clearinghouse Deposits and Net Capital

Updating the securities industry's clearinghouse deposit and net capital requirements, has freed-up over a billion dollars of capital and helped investment bankers and brokers finance the record volume of trading and financings, for the benefit of corporations and their shareholders.

Private Placements

Over $20 billion per annum is being raised from institutional and accredited investors at substantial savings under new private placement and small business exemptions from SEC registration requirements.

Proxy Simplification

Simplification and improvement of proxy statements and prospectuses have reduced their cost and increased their utility to investors.

SEC/CFTC Accord

The SEC-Commodity Futures Trading Commission Accord, ended a 7-year turf battle, and has permitted trading in new options and futures, which enable corporations and investors to hedge stock market, foreign currency and other risks, at a fraction of the costs of prior means of hedging or reducing such risks.

SEC Budget Surplus

Since 1981, the SEC's budget has been increased by over 33% - which is much more than for most independent agencies. In fact, most have been reduced. In any case, SEC registration, transfer and other fees have exceeded the Commission's $100 million budget in each of the last two years - which has only happened once before, in the past 50 years. The two year surplus has amounted to over $35 million. Also, the Commission's 1985 and 1986 surplus is expected to total over $50 million. So, the SEC is now making a modest contribution to a reduction in the federal deficit.

Automation and Paperwork Reduction

Through automation, paperwork reduction and other improvements, each SEC division has achieved record results - or the highest levels in years - in each of the last three years, with 5% less personnel.

Annual Volume Increases

Since 1981, the annual volume of:

- Enforcement actions has been increased by over 50%;
- Investment company, adviser and broker inspections by 40% to 75%;
- Full disclosure filings processed by 19%;
- And tri-annual accounting firm peer reviews, under the SEC's oversight, by over 100%.

Enforcement Priorities

Last year the Commission brought over 50 financial reporting cases against corporations and accountants. Many were products of the 1982 recession and the 1983 "hot new issue" market. It is during such periods that some companies are tempted to "cook the books". Major areas of enforcement actions in prospect include false and misleading financial disclosures, market manipulation and insider trading.

Intermarket Surveillance

At the Commission's initiative, new electronic intermarket, stock and options surveillance systems and transaction audit trails are facilitating the quick detection of market manipulators and inside traders - and also reducing transaction reconciliation costs, that are ultimately borne by investors.

SEC/Swiss Accord

The insider trading Accord with Switzerland is an important precedent, during this period of increasing internationalization of the securities markets. More remains to be done in this area.

Insider Trading Act

The Insider Trading Sanctions Act, proposed by the Commission, was passed last August. Most inside traders have only been compelled to disgorge their profits - which has not been much of a deterrent. Now they will be subject to fines up to three times their profits.

Edgar

In the opinion of many, the SEC's high speed electronic disclosure system - known as Edgar - will revolutionize the way in which many investment decisions are made and executed. It will dramatically accelerate the filing, processing, dissemination and analysis of corporate information and increase the efficiency and fairness of the securities markets. As corporate information is electronically filed with the Commission, it will be instantly accessible to the news media, investors and securities analysts on business and home computer screens.

Since the federal securities laws were enacted half a century ago, Edgar is the first improvement in the way corporate information is filed with the SEC and disseminated to the public. The rising mountain of paper - over six million pages - that is filed with the SEC each year, will be virtually eliminated. Through Edgar, detailed corporate information will be publicly available in a matter of minutes and hours, instead of days and weeks.

The Edgar pilot began on schedule, eight months ago. Since then, 150 voluntary corporate and other participants have filed over 800 documents with the Commission. The participants range from AT&T, Exxon, General Motors, IBM and other major corporations, to small companies and limited partnerships. GMAC, one of the most frequent filers, has indicated the system has enabled them to react quicker to changing market conditions and get to the market faster.

The voluntary participants are helping shape the system. They are also gaining valuable experience, and they will avoid the last minute crush as all corporations are phased into the system in 1986-88. Companies that are interested in participating, should contact the Commission.

The filings come in over telephone lines, and on diskettes and magnetic tapes, prepared on over 85 different types of word processors and computers. Electronic mail capabilities have recently been added. The indexing of financial statements and other analytical capabilities will also be added shortly.

Three state securities commissions - California, Wisconsin and Georgia - are presently participating in the pilot. A single filing with the SEC will soon serve all 50 state commissions, other federal agencies, the securities exchanges, the National Association of Securities Dealers, and virtually all others to whom corporations routinely distribute their SEC filings.

Edgar was created by a team - Arthur Andersen & Co., IBM, Dow Jones and the SEC staff. The Commission plans to solicit bids for the operational contract later this year and to begin phasing all corporations into Edgar next year. Before the end of 1988, all 10,000 publicly owned corporations are expected to be on Edgar.

Shareholder Communications

Rules adopted by the Commission, will also facilitate corporations' ability to communicate directly with their shareholders. Starting next January, brokers will be required to provide corporations with the identity of their shareholders, who do not object. The Commission has also proposed legislation to require the banks to provide such information.

Immobilization of Securities:

Another major effort is to accelerate the immobilization - and ultimate elimination - of securities certificates through the use of central depositories and high-speed electronic book-entry systems. The potential savings aggregate hundreds of millions of dollars per annum. But even in the absence of such savings, the speed and simplicity - the future paperwork and other problems avoided - more than justify the effort. The integration of financial services and markets today, is such that a paperwork crisis in any segment of the system would have very serious repercussions, throughout the nation and abroad.

Over the past 15 years, progress has been made. About half of all corporate stocks and bonds now repose in central depositories. Much more remains to be done - not only with the other half of corporate securities, but also with mortgage-backed and municipal securities.

The SEC has recently conducted workshops of industry executives and experts to help establish and implement the time schedules and programs for the national effort necessary to accelerate the immobilization and ultimate elimination of securities certificates.

There are many favorable precedents and developments - to name just two:

- France has commenced the conversion of all existing and new securities to an electronic book-entry system, within three years.

- And in February - the U.S. Treasury announced that it will stop issuing note and bond certificates next year. All future Treasury securities will be issued under a certificateless, electronic book-entry system.

Internationalization

Another major project concerns the increasing internationalization of the securities markets. For over two centuries, the United States has been a prime beneficiary of foreign investment.

With a view to facilitating the international mobility of capital, the SEC recently published two releases, suggesting approaches and soliciting comments on ways to harmonize and improve international disclosure, distribution, surveillance and enforcement practices - particularly for multi-national securities offerings in the United States, the United Kingdom and Canada. In addition to our common language, our securities laws, disclosure requirements and accounting practices are more similar than those of other countries.

Shareholder Voting Rights

Another very important issue to be addressed by the business and financial community, concerns the consequences of the erosion of shareholder voting rights, through corporate recapitalizations, super-majority charter and bylaw amendments, and new state statutes.

Since 1983, in response to the threat of hostile tender offers, hundreds of companies have implemented provisions, which limit shareholders' voting rights. Some companies have been willing to de-list from the New York Stock Exchange in order to do so. The New York Stock Exchange is reviewing its shareholder voting requirements. The over-the-counter market lacks such requirements. Several states have passed statutes which permit a small minority of shareholders to block corporate mergers.

Many serious questions are posed. Some contend that rising institutional ownership and the threat of hostile tender offers are causing managements to pursue short term objectives at the expense of research and development - and other long term programs that are in the best interest of shareholders and the nation.

Maybe, but a recent study by the SEC's Office of the Chief Economist discloses that target companies are characterized by low institutional ownership and R&D expenditures.

If shareholder voting rights continue to be eroded, will it invite federal intervention? Will shareholders tend to shift into other investments, which afford capital, a stronger "bargaining position" - than non-voting common stocks - such as debt issues and real estate?

Junk Bonds

Another area that warrants review at this time, is the rapid rise in the volume of so-called "Junk Bonds", or high yield bonds.

Over the past 50 years, high-yield bonds have served investors well. As compared with investment grade issues, their higher yields have more than covered their default experience. In addition, they have been more frequently upgraded than investment grade issues, which are sometimes downgraded.

With the benefit of studies that demonstrated the foregoing results, a few investment bankers and brokers began promoting high-yield bonds - about 20 years ago. A few mutual funds were formed, known as high yield bond funds.

From this modest beginning, the market for high yield bonds has been steadily increasing over the years. The results have been excellent and have attracted increasing numbers of institutional and individual investors.

The explosion in the market occurred last year, when high-yield bond offerings exceeded $15 billion - up from less than $2 billion in 1981. As a percentage of total corporate debt offerings, they rose from less than 5% in 1981 to over 18% last year. Private placements of such issues are also being used to finance corporate mergers, acquisitions and hostile tender offers.

The time has come to reassess the high yield bond market. During the period of the early studies, the market was insignificant by comparision with today. One can no longer take confidence in the fact that the favorable experience to date will persist indefinitely. As confidence builds, the tendency is to overdo a good thing. Excesses inevitably lead to a day of reckoning. High yield bonds are of very low quality. The corporate issuers are highly leveraged. Their fixed charge coverages are paper thin. Even a mild recession will have very serious repercussions for some of these companies.

Government Bond Market

Finally, another area of major concern is the recent failure of several government bond dealers - particularly ESM and Bevill, Bresler & Schulman. Over $500 million of losses - before taxes, insurance and civil suit recoveries, if any - have been sustained by those who dealt with these two firms. Such losses have been attributed principally to:

- ESM's and BBS's use of the same collateral for multiple transactions;

- Fraudulent concealment of their financial conditions; and

- In the case of ESM, over $200 million of its $300 million of losses have been attributed to transactions with two thrift institutions that were under the control of Marvin L. Warner.

The question is: How can such losses be inhibited or prevented on a cost-effective basis?

The annual dollar volume of trading in government securities is over 15 times that of all corporate securities. The government bond market is by far the world's largest and most efficient securities market. This highly liquid, keenly competitive market is of paramount importance to the effective administration of the nation's monetary and fiscal policies, including the financing of the national debt. If regulations were to increase interest rates on Treasury securities by 1/10th of 1%, it would increase federal interest costs by over $2 billion per annum - which is 4 times the recent losses.

And there is of course, no assurance that regulations would eradicate future mistakes and deceptions. Stock brokers are highly regulated, but we still have huge frauds, such as Bell & Beckwith and Stix & Company.

In conjunction with the Treasury and the Federal Reserve Board, the SEC is conducting an analysis and will report its conclusion to Congress by June 21st.

A threshold question is the reaction in the marketplace to the widely publicized ESM and BBS failures. Are those who deal in government securities now properly perfecting their collateral? Are they shifting from small to large dealers? Are there likely to be more failures as a result of an overreaction?

Should dealers be required to deliver, through the Fed's or other book-entry systems, government securities that are transferred or pledged under repurchase agreements? Should the Fed's proposed voluntary capital-adequacy guidelines for government dealers be made mandatory? Should those guidelines be expanded to include dealer registration and segregation of customers' positions, subject to audits and inspection by the Fed?

Should a self-regulatory organization be created under the aegis of the Fed or the SEC? Or should the authority of the Municipal Securities Rulemaking Board, which is under the SEC's oversight, be expanded to include government securities markets and dealers?

These are a few of the questions posed in a release published by the Commission last month and distributed to those who have suffered losses, as well as government securities dealers, industry groups and other regulatory organizations. The Commission's objective is to come-up with the most cost-effective response to the problem by June 21st.

These are some of the major issues pending at the SEC. I will be glad to amplify any of the topics mentioned, and I would appreciate your comments and suggestions.

Thank you.