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Misperceptions

John Shad

It is a pleasure to be with you today. I would like to address some misperceptions about the securities markets, highlight some of the Securities and Exchange Commission's activities, and then invite your comments and questions.

The Securities Markets

In Congressional hearings and other forums, it has been said that securities fraud has reached epidemic proportions.

There are far too many scams and schemes, market manipulators and inside traders, false and misleading corporate disclosures, and sales practice abuses by some brokers. The SEC, the state securities commissions, the Justice Department, the Self-Regulatory Organizations and the financial community are vigorously pursuing, exposing and prosecuting the perpetrators of these abuses, but there is no substitute for the leery investor, who investigates before he invests. If it sounds too good to be true - it is.

The markets are also subject to significant - sometimes violent - fluctuations, and there will continue to be periods of excessive optimism and pessimism, but as a result of the breadth and depth of the U.S. economy and the outstanding overall job being done by corporate America and the financial community - under the disclosure, surveillance and enforcement programs of the SEC and the other law enforcement agencies - America has today by far the best securities markets the world has ever known - the broadest, the most active and efficient and the fairest.

Over 100 million shares are being routinely traded daily. The ownership of over \$5 billion of corporate debt and equity securities, and many times that of government securities, is changing hands daily. By any account, not more than a tiny fraction of these transactions involve alleged - not proven - fraudulent activities. And bear in mind, it is easy for private litigants to allege securities fraud. It only costs about \$100 to type up a complaint, alleging million dollar damages. Most of these suits are resolved for a small fraction of the damages claimed.

And notwithstanding significant failures in other segments of the economy, there have been very few failures of the registered financial concerns and firms that are regulated by the SEC - some 12,000 investment advisers, 11,000 broker-dealers, 2,700 investment companies and 2,200 transfer agents, as well as the stock exchanges and the clearing agencies. These segments of the financial service industry have never been healthier - nor have they ever done a better job.

SEC Budget

Many independent agencies' budgets have been reduced, but contrary to a common misperception, since 1981 the SEC's budget has been increased by over 35%.

In any case, in each of the last three fiscal years, registration, transfer and other fees have exceeded the Commission's \$90 to \$106 million budget, which has only happened once before in the past 51 years. The three-year surplus has amounted to over \$70 million - and the 1986-87 surpluses are expected to aggregate over \$100 million. So the SEC is now making a contribution to a reduction in the federal deficit. The SEC's fees, budgets and personnel are set by Congress - not by the Commission. And the fees are remitted to the Treasury as received.

SEC Results

It has been said that the SEC's activities have been curtailed, or have not kept pace with the growth of the securities markets.

Since 1981, through automation, paperwork reduction, staff improvements and initiatives, each SEC division has achieved record results, or the highest levels in years, with 2% to 5% less personnel. Since 1981:

- o Full disclosure filings by corporations have increased by 26%, but SEC reviews of these filings have been increased by over 50%;
- o The number of broker-dealers has increased by 54%, but SEC oversight examinations have been increased by over 60% and Self-Regulatory Organization inspections by over 70%.
- o The number of investment companies and advisers has increased by 84%, but SEC inspections have been increased by over 100%.
- o The annual volume of investor complaints to the SEC have increased by 47%, but since 1982 all are being reviewed. Most involve back office complaints against brokers. They are referred to the Self-Regulatory Organizations or the brokers and are tracked through resolution. Others are referred to the Enforcement Division or the state securities commissions.

- o The daily volume of shares traded has increased by 133%, but the number of transactions has only increased by 26%, because of the significant increase in large transactions by institutions. SEC enforcement actions have been increased by over 40%.

These comparisons could be even better, but it is evident that the SEC's activities have not been curtailed - they have been expanded.

Ongoing Efforts

While our securities markets are the envy of the world, they are not perfect. However, tomorrow's markets will be even better than today's, as a result of ongoing SEC initiatives:

- o To increase the coordination of state, federal and Self-Regulatory Organization efforts;
- o To improve international surveillance, enforcement and settlement practices;
- o To accelerate the immobilization of securities certificates;
- o To disseminate electronically time-sensitive corporate information;
- o And to automate and reduce unnecessary paperwork and other expenses, ultimately borne by investors.

Debate on Takeovers

In the corporate takeover area, some contend that rising institutional ownership and the threat of takeovers are forcing corporate managements to forego long-term growth programs for short-term earnings results.

Others contend that takeovers bring the disciplines of the marketplace to bear on corporate managements, and accelerate the reallocation of assets, in response to changing economic conditions.

These and other reasonable contentions and concerns generally lack empirical support. So the debate goes on - but one fact is clear - shareholders are receiving billion dollar premiums for their shares.

A study by the SEC's Office of the Chief Economist of tender offers from 1981 through June of 1985 demonstrates that shareholders of target companies have received an average premium of 47%, over the prior market prices of their shares, which amounts to about \$39 billion. Other studies indicate that bidders' shares have risen an average of 4% net-of-the-market.

Given the substantial tangible benefits to shareholders and the lack of empirical evidence of harm to the economy, proposals that would deter takeovers must bear the burden of proof that they are justified. Rhetoric alone will not carry the issue.

From shareholders' point of view, reliance on the marketplace, the Commission's full disclosure and other requirements, and shareholders' voting and other rights under state and federal laws, has generally worked well.

From managements' point of view, a company's best defense to a takeover is a fairly valued stock. Corporate managements are in much better positions than outsiders to utilize their companies' enhanced borrowing capacities and asset values on a sound basis, for the benefit of their shareholders - and the vast majority are doing so.

The Past is Prologue

In 1981, at the securities industry's annual convention, I said, "Since the end of World War II, the nation's monetary, fiscal and regulatory policies have become increasingly antithetical to capital formation."

- o That, "Mounting regulatory burdens;
- o Rising inflation, corporate and individual taxes;
- o Inadequate depreciation allowances;
- o Double taxation of dividends;
- o And one of the highest effective rates of capital gains taxation in the industrialized free world;
- o Have been emphatic disincentives to saving and investing."

That, "As a consequence, America's relative rates of capital formation, productivity and growth [had] plummeted, from one of the highest to among the lowest of the industrialized nations."

That, "The Economic Recovery Act of 1981 [was] an excellent beginning, and that I [had] great confidence in the President's overall program."

And I pledged:

- o To help reduce excessive regulations;
- o To help facilitate, instead of inhibit, capital formation, corporate financings and efficient markets;
- o And to help maintain investors' confidence in our markets through more effective disclosure, oversight and antifraud enforcement.

Some of these goals and aspirations have come to pass. Among other things, the Economic Recovery Act of 1981 increased depreciation allowances by 14% and reduced the corporate, individual and capital gains tax rates by over 25%.

The rate of inflation has been brought down by over 60%, the prime rate by over 50%, our productivity and growth rates have more than doubled and about ten million new jobs have been created. All of which has given impetus to the broadest and strongest stock, bond and new issue markets in history.

Two ways in which the SEC can help investors are by increasing their protections on a cost-effective basis, and by reducing unnecessary expenses that they bear. The SEC is doing both.

Integration and Shelf Registration

For example, the SEC's integration of corporations' registration and reporting requirements and the shelf registration rule are saving corporations - for the benefit of their shareholders - well over a billion dollars per annum in interest, underwriting and paperwork costs - without compromising full disclosures to the investing public. Whether or not a company has filed a shelf registration statement, it must continue to make full disclosures of its interim and annual results and other material developments.

Private Placements

Over \$45 billion per annum of securities are being offered to institutional, accredited and other investors under new private placement and small business exemptions from SEC registration requirements, at savings of hundreds of millions of dollars per annum to companies and their shareholders. The small business exemptions are in response to Congressional directives.

Proxy Simplification

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

Institutional Book-Entry

Expansion of the institutional, electronic book-entry delivery system, in lieu of the physical delivery of securities by institutions, is saving hundreds of millions of dollars per annum of expenses ultimately borne by investors.

Clearinghouse Deposits and Net Capital

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

New Options and Futures

New options and futures, authorized by the SEC and the Commodity Futures Trading Commission, are permitting investors, corporations, banks and others to hedge stock market, foreign currency and other risks, at a fraction of the costs of prior means of hedging or reducing such risks - and in multi-billion dollar amounts that were not previously possible. These new financial instruments have also increased the breadth and liquidity of the securities and other markets.

A joint study by the Fed, the CFTC and the SEC has concluded that options and futures serve valid hedging and arbitrage purposes - and do not adversely impact capital formation.

Market Efficiency

Efforts to increase the breadth and efficiency of the securities markets also include recent Commission decisions:

- o To require disclosures of over-the-counter dealers' mark-ups.
- o To increase by over 100% to 2,200 the number of over-the-counter stocks that are subject to firm quotes and last sale reports;
- o To permit the New York Stock Exchange to trade certain options;
- o To permit the stock exchanges and over-the-counter dealers to make competitive markets in OTC options;
- o To test side-by-side marketmaking in OTC options and stocks, through a one-year pilot;
- o And to permit each of the stock exchanges to grant unlisted trading privileges in up to 25 over-the-counter stocks.

Effective market surveillance is an integral part of these new programs.

Insider Trading Sanctions Act

At the SEC's initiative, Congress enacted the Insider Trading Sanctions Act. Most inside traders have only been compelled to disgorge their profits - which has not been much of a deterrent. Now they are subject to fines - up to 3 times their profits, as well as disgorgements and criminal sanctions.

Intermarket Surveillance and Audit Trails

Also at the Commission's initiative, electronic surveillance of the stock and options markets and transaction audit trails have increased investor protections, and reduced transaction reconciliation costs - that are ultimately borne by investors.

Shareholders Communications

In order to facilitate shareholder communications, the Commission now requires brokers to disclose to corporations the identity of their shareholders, who do not object. Next January, similar disclosures will be required by the banks. Also, banks that engage in public brokerage activities are now subject to the same SEC rules and regulations as all other securities firms.

Internationalization

In the international area, today about 10% of the transactions on the New York Stock Exchange are originated abroad. The shares of over 400 companies are now actively trading in more than one country, and it seems inevitable, that within a year or two, a multiple of that will be trading around the clock and the world.

The increasing international mobility of capital offers enormous potential benefits to investors, corporations and the global economy - but there are obstacles to the effective surveillance and enforcement of fair and orderly international markets.

It is in the interest of all nations to expose and prosecute those who would use foreign secrecy and blocking laws to shield manipulative and other illegal activities - in our and other markets.

Some U.S. court decisions have been helpful. 1/ It has been held that those who play in our markets, must do so by our rules. The SEC has been able to freeze the proceeds of illegal transactions from abroad and recently obtained a record \$7.8 million disgorgement from those who traded through Swiss bank accounts in Santa Fe International on inside information. 2/

The SEC/Swiss Accord on insider trading has removed the haven of Swiss secrecy laws from tender offer inside traders. 3/ The Accord is an important international precedent, but it is only a beginning. Efforts are underway to improve international surveillance and enforcement practices and to accelerate the clearance and settlement of international transactions.

1/ See, e.g., SEC v. Banca Della Svizzera Italiana, 92 F.R.D. 111 (S.D.N.Y. 1981); IIT v. Cornfeld, 619 F.2d 909 (2d Cir. 1980); SEC v. Kasser, 548 F.2d 109 (3d Cir.), cert. denied, 431 U.S. 938 (1977).

2/ SEC v. Certain Unknown Purchasers (The Santa Fe case), 81 Civ. 6553 (W.C.C.) S.D.N.Y. 1981; SEC v. Banca Della Svizzera Italiana, 81 Civ. 1836 (M.P.) (S.D.N.Y. 1981).

3/ Memorandum of Understanding Between the Government of Switzerland and the United States Securities and Exchange Commission (Aug. 31, 1982).

Certificate Immobilization

The SEC is also attempting to accelerate the immobilization of securities certificates, through greater use of central depositories and electronic book-entry systems.

The manual handling of securities is costing corporations, the financial community and investors (who ultimately bear such costs) hundreds of millions of dollars per annum. And even in the absence of such potential savings, the paperwork and other problems that can be avoided, more than justify automating the process.

Very favorable reactions have been received from investment, corporate and financial executives to the following voluntary approach. Corporations, municipalities and others are being encouraged to do their future public offerings of debt securities in the form of single "Global Certificates" -- against which investors' interests are recorded by depositories on a book-entry basis.

The approach only involves new issues of debt securities. It does not involve stocks, and no investors will be required to turn in any of their existing certificates.

Certain remaining states are also being encouraged to update their statutes, that limit the use of central depositories by insurance companies 4/ or municipal pension funds 5/, or that have not as yet adopted the 1977 Uniform Commercial Code amendments -- which facilitate uncertificated securities interests. 6/ Such outdated state statutes do not prevent the use of book-entry systems, they do impose unnecessary costs on investors, corporations and the financial community.

There are many favorable developments. There have been over \$2 billion of money-market debt and preferred offerings, and over a billion dollars of state and municipal bond offerings on a book-entry basis. IBM Credit has filed a billion dollars of debt, all or a portion of which may be issued on a book-entry basis.

And most important -- starting this year, all future Treasury securities will be issued solely on an electronic book-entry basis.

Securities certificates will not be eliminated in the near future, but billion dollar benefits will be realized - and future problems avoided - by gradually turning off the flow of new paper into the marketplace.

4/ Ark., Calif., La., N.M., S.D., Ut., W.Va. and Wy.

5/ N.J., Ohio, Ok., Tex. and Wy.

6/ The states that have adopted the 1977 UCC amendments are: Calif., Col., Conn., Del., Mass., Minn., Mont., N.Y., Ohio, Ok., Tex., Va., W.Va. and Wy.

Electronic Disclosures

The SEC's pilot electronic disclosure system, known as Edgar (for Electronic Data Gathering Analysis and Retrieval), has demonstrated the feasibility and multiple advantages of electronic dissemination of time-sensitive corporate information. The system has been designed by the SEC staff, Arthur Andersen, IBM and Dow Jones, to increase the efficiency and fairness of the securities markets by accelerating dramatically the filing, processing, dissemination and analysis of corporate information. Full disclosures by corporations will be instantly available on home and office computer screens. The Institutional Investor has indicated that Edgar may revolutionize the manner in which investment decisions are made and executed.

Participants in the pilot include AT&T, General Motors, IBM, Exxon and other large and small companies as well as the California, Georgia and Wisconsin state securities commissions. Over 370 participants have filed electronically over 5,000 documents.

Subject to government approvals, the SEC plans to select the prime contractor for the operational Edgar system in fiscal 1987, and phase-in the 11,000 publicly-owned companies and 2,700 investment companies over the next three years.

Market Rumors and Trading Halts

At a recent SEC Roundtable meeting, the Commission discussed market rumors and trading halts with the Chairmen of the New York and American stock exchanges, the NASD, corporations and other experts. Issues under study include:

- o Whether trading in all markets in a security should be suspended, when the primary market halts trading;
- o Whether there should be a "safe harbor" for corporate responses that are accurate when made, without requiring subsequent announcements as a result of new developments;
- o And whether rewards should be offered to those who provide information that results in successful prosecutions and disgorgements.

The IRS and the Departments of Justice and Defense have such rewards programs.

Regulatory Roundtable

The Commission also recently held a Roundtable discussion on the coordination of surveillance and enforcement programs with:

- o Representatives of the state securities commissions;
- o The Presidents of the New York and American stock exchanges, the Chicago Board Options Exchange and the National Association of Securities Dealers;
- o And the head of the Justice Department's Fraud Unit.

Approaches under consideration include:

- o Guidelines of the areas of responsibility of the Self-Regulatory Organizations, the state and federal authorities;
- o Referral and follow-up procedures and practices;
- o And the State Commissions providing greater subpoena assistance to the Self-Regulatory Organizations.

Conclusion

In conclusion, as mentioned at the outset, America has today by far the best securities markets the world has ever known, but they are not perfect. Tomorrow's markets will be even better than today's as a result of these ongoing efforts and programs.

Thank you.

I will be glad to respond to any questions.