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News Release

THE FUTURE COURSE OF SEC REGULATION

Remarks to

A Seminar on the Washington Scene

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I have been asked to speak to you today on the future course of SEC regulation. Certain SEC regulatory activities have been receiving much attention in the press lately -- not only in the Wall Street Journal and the business section of the New York Times, but in nightly television newscasts and on the pages of magazines that rarely devote copy to matters that make financial news.

It would seem to the average citizen that we at the SEC have gathered forces and have gone on a sudden rampage to "crack down" on Wall Street arbitrageurs, investment bankers and other securities professionals.

It may be difficult for certain former arbitrageurs and investment bankers to appreciate that the SEC's prosecutorial activities are only a small, albeit well publicized, segment of SEC business as usual. In order to appreciate a future prospective of SEC regulation it is necessary to disregard the myopic perspective and to begin to take the birds eye view.

Speaking of birds, I am reminded of a cartoon that I saw in a recent issue of the New Yorker Magazine. The cartoon shows a businessman seated at his desk. There is a Quotron machine conspicuously placed to his right. Perched on his windowsill, slightly in the background, is the proverbial "little bird."

The high powered executive slips his eyeglasses off the tip of his nose and officiously says to the bird: "You realize, of course, that any attempt on my part to profit by this information would put me at risk of an investigation by the SEC."

Well, obviously that scenario takes the law of insider trading a bit too far. Before alleging a violation of Rule 10b-5, we would first have to establish that the bird did, in fact, owe a fiduciary duty to the corporation and that the businessman, to whom the bird sang, had reason to believe that the bird was breaching that duty. So you see, the media has clearly blown this issue out of proportion.

This afternoon I will give you an update on some of the hottest topics facing the various divisions at the Commission. To the extent that I am able, I will disclose a near future outcome for issues currently in the pipeline as well as some long term objectives at the Commission.

We will look to the Division of Enforcement for the true story on insider trading; to the Division of Market Regulation for the latest on one-share, one-vote and program trading; to the Division of Corporation Finance for a look at Edgar, Internationalization and prospectus delivery, and finally, to the Division of Investment Management for some thoughts on their study of the financial planning and investment advisory industries.

DIVISION OF ENFORCEMENT

Beginning with the Division of Enforcement, I would like to give you my interpretation of the insider trading phenomenon. Despite all of the attention that our investigations on insider trading have received lately, it might surprise you to know that insider trading makes up a mere nine percent of the SEC's enforcement program. While the program has averaged close to seven percent of its overall cases for the last four years, and will probably see an increase to anywhere from twelve to fifteen percent over the next year, insider trading far from dominates enforcement's allocation of resources. 1/

Many people have asked me: if insider trading still represents such a small percentage of staff resources, and if business is as usual at the SEC, then why all the publicity? The answer is simple. While the policies on insider trading have remained essentially the same, the profile of the individuals being charged and the amounts of ill-gotten gains have changed significantly. This year alone, the SEC will recover in excess of thirty million dollars in disgorgement.

The fact that clues have led our investigative team to find "Colonel Mustard in the Green room holding the lead pipe" -- or more precisely, Dennis Levine of Drexel Burnham Lambert in the Bahamas with 12.6 million dollars is perhaps fortuitous, but not the making of new law or the first blow of a full blown attack on the financial wizards.

1/ As of June 30, 1986, the Enforcement cases initiated by the Commission, during the preceding three quarters, showed the following: (1) securities offering cases - 25%; (2) broker-dealer cases - 23%; (3) issuer financial statement and reporting cases - 16%; (4) insider trading cases - 9%; (5) other regulated entity cases, such as investment advisers, investment companies and transfer agents - 9%; (6) contempt proceedings, both criminal and civil - 6%; (7) corporate control violations - 2%; (8) market manipulation cases - 2%; (9) fraud against a regulated entity - 1%; (10) related party transactions - 1%; and (11) delinquent filings - 6%.

Individual violators such as Dennis Levine, Ira B. Sokolow of Shearson Lehman Brothers, Robert Wilkis of Lazard Freres & Company, David S. Brown of Goldman, Sachs & Company, and the famed "Yuppie four" merely bring the problems of insider trading to new levels of greed and disloyalty, but the broad presence that the SEC has maintained on Wall Street remains unchanged. Rather than adopting new priorities, I would say that we are sailing ahead on a well traveled course. If there is a priority on enforcement's agenda, it is to crack down on hard core fraudulent practices wherever and whenever they are found.

One area of particular interest to me and one that Gary Lynch, the Director of the Division of Enforcement, has stated "is a trend," is the marked increase in criminal prosecutions. 2/ The number of chronic violators illustrates that there is a certain breed of securities violator to whom a civil injunction means little. Criminal prosecution, on the other hand, obviously presents a greater threat to the individual violator and has a proven deterring effect in the securities community. While the percentage of insider trading cases has risen only slightly, the total number of contempt proceedings, both civil and criminal, over the past year has risen from a mere three to thirteen.

Before leaving my discussion of the Division of Enforcement, I would like to mention the subject of barring violators from being officers or directors of public corporations. While this may not represent a future priority for the enforcement staff, it is certainly on my agenda as I cannot conceive of a situation where I would find it appropriate to vote in favor of such a remedy.

Simply put, I believe that the Commission was not given an explicit mandate to bar individuals from the boardroom. Where an existing or potential officer or director of a public company has past securities violations, and such violations are fully disclosed to the shareholder, I do not believe that it is the Commission's job to, in essence, create bars from activities that Congress did not see fit to include.

There is no question that Congress authorized the Commission to bar individual violators from associating with brokers, dealers, investment advisers, or investment companies. In the case of a bar from a public company, however, where it is clear that the shareholders can make an informed choice as to whether or not the individual,

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2/ See 18 SRLR 1202, August 15, 1985.

given his past "bad" conduct, is an appropriate boardmember, I do not believe that the Commission should accept the remedy simply because it may have been offered by the respondent's counsel.

DIVISION OF MARKET REGULATION

Program Trading

With respect to the Division of Market Regulation, probably the most talked about issue that has come out of Market Regulation this year is that of program trading. The stock market volatility that has been associated with program or arbitrage trading strategies, involving options and futures on stock indexes and their underlying component stocks, is still perceived as somewhat of an enigma to the general public.

Such terms as "triple witching days," that is, the third Fridays of March, June, September and December when individual stock options and contracts for stock index options and futures all expire, do not help to demystify program trading for the small investor. Indeed, there is an increased public perception that the fairness and integrity of the securities market may be in jeopardy.

Market Regulation has been studying the various problems associated with program trading for nearly two years now. On June 13, 1986, the Commission requested comments from certain self-regulatory organizations on several proposed alternative solutions to address the stock market volatility on Expiration Fridays. 3/ Three such alternatives were: (1) disclosure of order imbalances; (2) disclosure of anticipated trading activity; and (3) settlement based on opening prices. The SRO's have strenuously disagreed on the appropriate approach. The CBOE, for example, is of the belief that the best approach would be to alter procedures at the close. This could take the form of requiring the early entry of market-on-close orders or the disclosure of anticipated trading activity. The AMEX, on the other hand, strongly supports the early entry of market-on-close orders by either 3:30 or 3:45 p.m.

Yesterday, the Commission authorized the issuance of a letter to John Phelan, Chairman of the New York Stock Exchange, urging that net order imbalances be displayed, on

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3/ *See* letter from Shirley E. Hollis, Acting Secretary, to Kenneth R. Leibler, President, American Stock Exchange, *et al.*, dated June 13, 1986.

the low speed tape, by 3:30 p.m. While this may not be the best or the final solution, the action was taken in anticipation of the next expiration date on September 19, 1986.

ONE-SHARE, ONE-VOTE

As you may be aware, the Board of Directors of the New York Stock Exchange has finally voted to allow companies to list more than one class of common stock on the exchange. The Commission has not received a rule filing to date, but based on a release issued by the NYSE on July 3, 1986, the amendment to the listing standards would contain the following restrictions: (1) that a majority of the company's independent shareholders approve the dual classes of stock; and (2) that a majority of the independent directors must approve the stock.

The New York Stock Exchange has had an informal moratorium on delisting companies that are in violation of their shareholder participation requirements since July, 1984, and has made numerous exceptions to allow dual classes of common stock during the pendency.

The staff expects to receive the proposed rule filing under Rule 19b-4 of the 1934 Exchange Act sometime this month, and will submit it to the Commission for consideration at a public meeting.

As I have publicly stated many times before, I find the theoretical arguments equating corporate democracy with one-share, one-vote and the underlying belief that the adoption of dual class capitalization is somehow against the best interest of the shareholder, to be unpersuasive. It should come as no surprise that the Board has finally acted in response to the competitive pressures felt primarily from the NASD. I look forward to reviewing the future filing with interest.

RETAIL FIRMS ACQUIRING SPECIALISTS

Another issue with which the Division of Market Regulation is grappling is the issue of retail firms being permitted to buy up specialist firms and the potential consequences inherent in such an arrangement.

As some of you may recall, the Commission issued a release for comment on this topic in September of last year. 4/ The release was in response to a dual request for a rule change by the New York Stock Exchange and the American Stock Exchange to amend the Exchanges' rules governing approved persons of specialists. The staff received some thirteen comment letters in response to the release.

Without embarking on a lengthy discussion on an issue that I may soon be called upon to consider, I will say that the Division is expected to submit its recommendation to the Commission within the next month.

DIVISION OF CORPORATION FINANCE

Edgar

I would like to turn now to the Division of Corporation Finance and the Edgar project. At the risk of sounding self congratulatory, I believe that the SEC, through the Edgar Pilot, has taken the first step toward revolutionizing the world markets. When Edgar is fully operational, by late 1987 or early 1988, it is expected to greatly increase the efficiency and fairness of the securities markets for investors and corporations alike. To date, over 8,600 filings have been processed through the system. Of that figure, 4,120 represent filings to the Division of Corporation Finance. An additional 4,223 of those filings are directed to the Division of Investment Management, and some 317 to the Office of Public Utility Regulation.

On September 3, 1986, the Commission issued a release extending the date for submission of bids on the operational Edgar system from September 10th to December 31st. As we stated in our release, the extension was made to enable the Commission to fully consider comments received from potential bidders and others.

INTERNATIONALIZATION

Next to Edgar, the most frequently asked question that I have received involving the Division of Corporation Finance, is: What ever happened to the concept release on

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4/ See Securities Exchange Act Release No. 22396, 50 Fed. Reg. 37925, September 18, 1985.

Internationalization? 5/ The release, which was published for comment in March of last year, presented two approaches to facilitate multinational offerings: the reciprocal approach and the common prospectus approach.

Briefly, the reciprocal approach would entail an agreement among participating countries that a prospectus accepted in an issuer's domicile and that meets certain standards would be accepted for offerings in each of the participating countries. It was suggested that the countries of the United States, the United Kingdom and Canada be chosen in part because of certain similarities in disclosure requirements among the countries.

The common prospectus approach, by contrast, would entail the development of a common prospectus that would be filed simultaneously with each of the country's respective securities administrators. I note that the reciprocal approach was overwhelmingly favored by the commentators.

In addition to the views of the seventy commentators that responded to the issues raised in the concept release, the staff has had a continuous dialogue with representatives from other countries. Having personally participated in many of these meetings, I can tell you that the quest for the facilitation of multinational securities offerings has not been abandoned. In fact, I am assured by members of the staff that this project remains on the front burner and that the Division of Corporation Finance will recommend specific proposals, along with other possible approaches within the next few months. Full internationalization of the securities markets <u>is</u> in our future. I believe that we must set our sights to include not only the more established markets, such as those of London and Japan, but help pave the road for some of the less developed financial markets.

<u>SIA PROSPECTUS DELIVERY</u>

The Commission has recently authorized the staff to draft a release requesting comments on a petition for rulemaking, submitted by the Securities Industry Association, that would allow the delivery of a confirmation of a purchase in a registered public offering prior to the delivery of a prospectus. It is the SIA's position that the existing prospectus delivery requirements

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5/ <u>See</u> Securities Act Release No. 6568, 50 Fed. Reg. 9281, March 7, 1985.

under the Securities Act of 1933 are overly burdensome and costly; particularly in syndicated public offerings.

While it is premature for me to discuss these projects with you in any detail today, the Division is currently working on several projects that would affect the future of prospectus delivery and registration requirements. One such rule that has been suggested would, under certain conditions, provide a safe harbor exemption for private resales of securities to institutional investors and dealers.

DIVISION OF INVESTMENT MANAGEMENT

Last, but certainly not least, are the challenging and far reaching projects underway in the Division of Investment Management. Investment Management, among other things, has the responsibility of administering the Investment Company and the Investment Advisers Acts of 1940, as they apply to the regulation of and disclosure by investment companies and investment advisers respectively.

The rapid growth over the past few years in the industry generally, and in money market instruments and pension funds specifically, combined with the intense competition among investment companies and other types of financial institutions, has caused the Division to respond with several initiatives that would require both regulatory and legislative change.

Since 1981 alone, the number of active registered investment advisers has risen from 4,200 to approximately 10,000. At the June 11, 1986 Congressional Hearing on Financial Planners and Investment Advisers, which focused on many of the abuses associated with the growing financial planning and investment advisory industries, the Subcommittee requested that the SEC coordinate and supervise a comprehensive study of the industry, its problems and possible solutions. The study, that is now underway, is expected to extend through 1987 and should provide an analysis of the composition of the financial planner population, their clients, components of financial planning advice, ethical and educational standards as well as certain conflicts of interest and abuses.

This past May, the Commission approved a legislative proposal to amend the Investment Advisers Amendment Act of 1986. While the proposal was withdrawn for technical reasons, the staff of the Division remains hard at work on the legislation. The legislation was intended to clarify certain questions that remain in the wake of the decision in Lowe. 6/ Among, other things, the proposal would have clarified the applicability of the antifraud provisions of the Advisers Act to certain investment publications while exempting from registration those advisers who provide solely impersonal advice.

These and other ongoing projects to reexamine the adequacy of the current statutory structure for investment companies and investment advisers will reshape SEC regulation as we know it today. I believe that it is essential that we take these necessary steps to insure that the costs and burdens of government regulation do not exceed what is necessary to assure our primary mandate -- that of investor protection.

The sheer number of individuals offering traditional or hybrid forms of investment advisory services, and the increase in competition, are developments that were not contemplated in the year 1940. It is for these reasons that the Division of Investment Management and the Commission are taking a hard look at the adequacy of the present statutory framework with the hopes that the changes currently underway will still be viable fifty years from today.

CONCLUSION

The specific issues that I have just highlighted essentially give you a preview of significant matters that are currently being examined by the various Divisions of the SEC and that are likely to impact the financial markets for many years to come. A view into the more distant future, for example, two or three decades from now, conjures an image of a far greater change than we have ever seen at the SEC. As we enter the Information Age and begin to face the realization of the technological revolution, we recognize that Edgar is only a first step, and program trading an early consequence.

When we have seen full and harmonious internationalization of the securities markets, when there is sharing of information on all enforcement matters, full implementation of linkages from continent to continent, and an almost paperless securities world from the floor of the NYSE to the settlement and clearing process, then we will have met the distant future. Then such innovations as 24-hour trading and the idea of global immobilization will be

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6/ See Lowe v. Securities and Exchange Commission, 105 S. Ct. 2557 (1985).

a matter of course. Then we will be proud to have called Edgar and all the other innovative changes at the SEC mere first steps.