

# NEWS

## SECURITIES AND EXCHANGE COMMISSION

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THE BIG ENFORCEMENT CASES:  
THEIR IMPACT ON INVESTOR CONFIDENCE

An Address by  
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Securities and Exchange Commission

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Society of American  
Business Writers  
Warwick Hotel  
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Noting the representation at this tenth annual meeting of the Society of American Business Writers reminds me again of how much of the real effect of the disclosure laws is carried out by the financial press. Just watching the stream of financial news that pours out of the Dow Jones and Reuters printers we have at the Commission, you can't help but get a sense of the massive amount of information made available to the investor. Add to that the expanding and increasingly sophisticated coverage provided by newspapers, financial publications, and to some extent, the electronic media, and you have a very impressive composite picture of a disclosure and information dissemination process that is one of the reasons that America's capital markets are the envy of the world. Those of you in the financial press and we at the Commission share a common concern for the future of this investment system and the information process which sustains it.

It is not often, with all the policy issues confronting us, that I am able to talk about the Commission's role as cop on the beat. I would like to do that today. The enforcement role of the Commission is one that many people take for granted. Now it is being tested as never before. I believe I can say that at this moment,

we have more major cases in the courts and pending before the Commission than at any other time in the history of the SEC. I would like to talk to you about the scope of some of the cases we have brought, cite some of the reasons we believe their impact is a matter of great concern, and point out some of the approaches the Commission is taking in implementation of the federal securities laws to deal with the growing problem of diminished investor confidence. In the course of this talk, I want to stress a little-known aspect of disclosure that is drawing more attention at the Commission as the scope and complexity of enforcement matters grows. That is the enforcement side of disclosure -- the "teeth" which we are increasingly putting into required filings -- to put management on notice that statements filed with the Commission -- if these statements are misleading -- carry with them civil and criminal penalties.

#### Impact of Today's Cases

In my opinion, it is not the number of the cases being brought by the Commission that is remarkable. It is their size. In some measure, this reflects the increased concentration of public trust in larger

and larger pools of investment capital. The danger, of course, is that it only takes of few betrayals of trust to deal a shattering blow to public confidence. The sheer size of many of these financial complexes gives a pretty clear picture of the potential impact of wrong-doing.

I don't think I have to document the institutionalization of savings and investment capital in recent years. The emergence of one recent and popular investment vehicle for real estate, the real estate investment trust, illustrates how a pool of capital can triple in size in a few years. Last year, real estate investment trusts reported almost \$13.5 billion in assets, compared with less than \$5 billion in as recent a year as 1970. In 1969 and 1970, years which were not kind to the stock market, stock offerings by real estate investment trusts made up over 11 percent of total corporate financing by equities. I mention these figures only to drive home how quickly public capital can flow into new investment vehicles. Certainly, the growth of the mutual fund industry just in the last decade, to a business with more than \$67 billion in assets, demonstrates the dramatic flow of public money into institutions over longer, sustained periods. Private

non-insured pension funds today control staggering amounts of assets, some \$150 billion.

The vast public trust represented in this institutionalization of savings puts an increasing burden of responsibility on the people who manage this money. That is the way it should be. The saga of Equity Funding Corporation of America demonstrates vividly the threat to public confidence that a single case of these dimensions can bring. The imagination is challenged by reports that billions of dollars in non-existent insurance policies were put on the books of the company to get cash flow and to create the illusion of dramatic growth. That is only part of the picture. The lawsuits and the counter-suits, the allegations of misuse of inside information, the misrepresentations in disclosure filings -- all work to unravel an already torn fabric of investor confidence in the fairness and integrity of the market system. To put it more precisely: When the stock of a company such as this with a substantial following turns out to represent false values and thousands of investors are burned in the aftermath of forced disclosures, the damage to the investment process is considerable.

The scope of the Commission's charges against Robert L. Vesco and International Controls Corporation is another example of the massive dimension of current cases. In one of the largest cases ever brought by the SEC, Vesco and 40 other defendants were alleged to have carried out a systematic diversion of hundreds of millions of dollars in assets of the huge IOS mutual fund complex into companies controlled by Vesco.

The Commission's case against Everest Management Corporation is still another example of the magnitude of today's enforcement actions. Indictments continue to be returned in this case, which originated in the filing by the SEC in late 1971 of injunctive action against 44 defendants charging violations of the anti-fraud provisions of the federal securities laws -- violations which included gross abuse of trust, breach of fiduciary duty and kickbacks. Investment advisors of offshore and domestic mutual funds were among the defendants. In indictments returned in the Southern District of New York, fund managers and attorneys were charged with

participating in schemes to loot assets of mutual funds and companies and manipulating the prices of stocks. Included in these allegations was the "parking" of stock with nominee accounts to give the appearance that a distribution had been completed and a huge demand for the stock created.

I don't want to leave you with the impression that our enforcement concerns are totally focused on large institutional pools of capital. The Commission's action last year against the Dare To Be Great pyramid promotion complex did not involve a financial institution but does show how quickly some new promotions can soak up public funds. It has been estimated that 150 pyramid promotion schemes are in operation in this country and involve some \$300 million. The Commission obtained a preliminary injunction which requires that what is sold in the Dare To Be Great complex be registered as securities. The defendant is appealing to the Supreme Court. I should say now that in the event our court actions don't stem the tide of these promotions, which live off less sophisticated, less affluent people, we should seek legislation to do the job.

Still another challenging and complex enforcement area involves the sale of municipal bonds, now unregulated. Last year, we moved successfully against 19 defendants in the Memphis, Tennessee area in alleged boiler room sales schemes involving fraudulent misrepresentations and excessive mark-ups in prices of municipal bonds sold to the public. We have uncovered evidence of similar operations in other parts of the country. The staff, at my direction, has been working on regulatory proposals for municipal bonds which would require legislation and they will be presented to the Commission for consideration. Municipal bonds are securities; current abuses demonstrate that comprehensive regulation is needed.

#### Current Approaches in Enforcement

In my opinion, the problems posed by these unique enforcement problems can be met through several basic approaches: one is legislation; another is development of more reporting procedures with built-in enforcement aspects; a third is providing greater dissemination for important disclosures which might otherwise be obscured to the public; a fourth approach involves a tougher crackdown on the misuse of inside



information -- probably the most frequent violation of the federal securities laws today.

1. Legislation

In addition to the legislative concerns I've mentioned, we have other enforcement-related legislative plans. I think the quality of enforcement of the securities laws is directly tied to the quality of disclosure in the markets. Despite all of the studies and reports in recent years, I don't believe we know enough about the activities of institutions in the market - particularly those of pension funds, banks, insurance companies and the like who exert great influence and channel ever increasing amounts of investment capital. A complete picture of this market activity and a composite view of institutional holdings in each security simply don't exist. So, we are in the position of constantly talking about institutional activity and holdings without really having the full basis to view all of it. The time has come to take the mystique out of institutional ownership and trading activities in securities.

As I indicated last month, the Commission plans to ask the Congress to pass as an Institutional Disclosure Act which would give the SEC rulemaking power to require all types of institutional investors -- banks, insurance companies, pension funds, and the like -- to disclose holdings and transactions in securities over which they have investment authority.

My preliminary view is that we might require institutions to report holdings as of the end of each quarter and their past quarter's block transactions (one possible definition might be transactions involving 10,000 shares or 1% of the shares outstanding, whichever is less). I believe that institutions will be anxious to provide this information to demonstrate that their market behavior is fair and proper; moreover, the information could be provided from the computer records presently maintained by most institutions.

For the individual investor, one of the benefits of this reporting would be to present a composite picture of the

extent of institutional holdings and activity in a stock he owns or is thinking of buying or selling. Pulling this information together presents a sizeable collating effort which might involve the Commission or even private interests to insure rapid public availability of this information. In any case, full disclosure of all institutional activity is long overdue and would go a long way to dispel a growing public concern over institutional domination of market trading in securities -- a concern nourished by the lack of easily available facts about what all institutions are really doing.

The increasing internationalization of the capital markets and the magnitude of enforcement cases involving offshore funds point up the need for other legislation. In April, the Commission submitted to the Congress legislative proposals which would enable creation of foreign portfolio sales corporations to be organized in the United States for the sale of mutual fund shares to foreigners. These proposals were prepared in cooperation with the Treasury Department and would amend both the Investment Company Act and the Internal Revenue Code.

The regulatory void that now exists in the area of offshore funds must be filled. We believe that foreign investor confidence in offshore funds investing in American securities could be bolstered if they were subject to SEC regulation. At the same time, the impact of the legislation would permit organization of these sales corporations in the United States without changing the basic tax effect on the fund or on the foreign shareholders.

## 2. Enforcement in SEC Filings

As I have indicated, disclosure really has two aspects: one is information on which investors can make informed judgments; the other is a record on which the agency charged with enforcement can determine whether there was misconduct or misinformation. So, another key approach increasingly is to build an aspect of enforcement into disclosure filings. To take one example, the Commission has developed Rule 144 which governs the sale of restricted stock -- that is, stock

sold by controlling persons of issuers or acquired directly or indirectly from issuers or such controlling persons in transactions not involving a public offering.

On the 144 form itself the seller, to use the language of the form, "represents by signing the form that he does not know any material adverse information in regard to the current and prospective operations of the issuer of the securities to be sold which has not been publicly disclosed." The form also indicates that intentional misstatements or omissions of facts constitute federal criminal violations. We believe this procedure is a two-edged sword: like regular insider trading forms which officers, directors and 10 per cent holders of a company's stock must complete, there is the deterrent aspect of having to report the transaction. Here, in addition, the completion of the form and the sale of the stock automatically subject the person to prosecution when it can be established that the sale was completed with knowledge of adverse material information which is not public. I am sure you have noted the reports in the press of 144 sales by top officers of Equity Funding shortly prior to the filing of the SEC's injunctive action against the company in Los Angeles. The forms contained the representation that they knew of no adverse developments which had not been made public.

Another example of disclosure with an enforcement aspect is the recent requirement that companies or people acquiring more than 5 per cent of any corporation's stock file this information with the Commission and indicate as well the purpose of this acquisition. This filing was the basis of a recent injunction obtained by the Commission against an investment partnership which had succeeded through purchases of stock and call options in accumulating 27 per cent of the outstanding common stock of Vetco Offshore Industries. I should point out that this 13-d filing, which required legislation, won the support of some corporate management when it was realized that the disclosure of 5 per cent ownership could indicate that a take-over attempt was in progress. In the case of our forthcoming legislation to achieve full disclosure of institutional holdings and trading, I hope we can get support both from corporations, which are voicing growing concern over the institutionalization of the markets, and the institutions themselves in the public interest.

### 3. Surfacing Important Filings

Making investors aware of SEC filings that might otherwise go unnoticed is a vital part of the disclosure process and has meaning in the enforcement area as well. Let me cite two current examples. I've mentioned the filings companies or persons must make when they acquire 5 per cent of the stock of another corporation. We now list these filings on a weekly basis in the SEC News Digest for the financial press and the thousands of corporate officials, broker/dealers, lawyers, accountants and others who subscribe to that publication. This is part of an expanding program of information dissemination at the Commission.

By the same token, we have called attention to another filing in both the News Digest and in the SEC's Weekly Statistical Bulletin. When a company changes auditors for any reason, it is required to notify the Commission on Form 8-K, a standard disclosure form for material events. When the change of auditors has stemmed from a disagreement on

policy, we require the company to explain the difference by letter in its filing and we require the auditor to comment on the company's explanation. Notice of these latter filings now appears in these publications on a weekly basis.

4. Inside Information: A Special Problem

Finally as I have indicated several times misuse of inside information is a problem we intend to confront head-on by both clarifying the law in a forthcoming White Paper and by working increasingly to seek criminal referrals to the Department of Justice in some cases. From my experience, I think the movement of inside information in the cases we have seen generally involves its delivery to institutions or their agents for various considerations. I have been told informally that the Commission's statements that it intends to choke off this flow are naive, that these statements just don't recognize how the market really works, and that this sort of thing goes on every day of the week. To these people I will say this:



When we increasingly offer violators of the federal securities laws the prospect of substantial civil liabilities or jail terms, I would like to hear your comments further. In the meantime, the stakes are big and growing bigger. We are talking about whether people are going to believe in the market system and whether they are going to use it as direct buyers and sellers of securities. Not only is there danger if fiduciaries look at the money under their charge as amorphous dollars which don't belong to real people. There is an equal danger when the buyers of securities sold into the market as a result of material, inside information aren't looked on as real people either. In both cases, we get a crisis of confidence and a breakdown in the trust which builds capital markets. And that trust is something we cannot afford to lose.