

# NEWS

## SECURITIES AND EXCHANGE COMMISSION

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NORTH AMERICAN SECURITIES ADMINISTRATORS' ASSOCIATION

ANNUAL CONVENTION

AN ADDRESS BY

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SECURITIES AND EXCHANGE COMMISSION

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I rise this morning primarily to pay tribute to an extraordinarily successful cooperative effort between the Commission and all of you with respect to the regulation of business activity -- an achievement that has dressed regulatory reform in its finest garb.

The irony is that, in the same year that your state agencies, together with the Commission, have created a real, functioning and important reform in rationalizing our overlapping jurisdictions, we are facing the reality that this same overlapping jurisdiction threatens to create a considerable conflict in corporate regulation, one that could reach even constitutional proportions.

Let me speak first of our accomplishments. Our uniform registration forms for brokers and dealers and their agents and our so-called Form U-4 jointly developed by the SEC and by 49 states are uniquely successful. These new forms should substantially reduce the paperwork burdens of registrants who have registered with multiple self-regulatory or regulatory organizations.

Previously, each of us required a separate application from a single registrant despite the fact that the information being elicited from each of us is substantially the same. We understand that the savings potential of the action we have taken to date may mean the difference between an overall profit or loss to many brokers-dealers. This monumental task was completed with the substantial help of your organization

working with the self-regulatory organizations, the Report Coordinating Group and the Commission's staff.

These same organizations have been engaged in an effort to simplify the financial and operational reporting forms used by brokers and dealers. These efforts, to date, have produced a uniform system of financial reporting known as the FOCUS Report, which is now adopted by our Commission, the self-regulatory organizations and approximately 40 states. The FOCUS system supersedes existing uncoordinated systems with integrated general purpose financial statements. The system consolidates broker-dealer reporting requirements for many purposes: surveillance, annual audits, customer statements, and economic data collection. This common sense effort to reduce the multiplicity of forms and the frequency of filing requirements must surely be a beacon for all other government agencies.

We are now engaged in a more ambitious application of our prior success -- the creation of a single filing place and central data base for uniform registration forms. The Commission, the NASD, and the states of Massachusetts, Virginia, Michigan and Tennessee are now cooperating in a pilot project to determine its feasibility. The system will be structured so that information filed with the Commission by brokers, dealers and their agents will be processed by the NASD and provided to the states in a computer printout. If the pilot succeeds, the system will be available to, and hopefully adopted by, the remainder of the states.

The system can have truly majestic results:

- 1) the paperwork burden of collecting, reviewing and processing substantial numbers of forms will be reduced by a factor of two score or more;
- 2) the responsibility of enforcing compliance with the registration requirements of these agencies will be focused in one place;
- 3) all of the information in the data base will be available in a far more meaningful fashion to all these regulatory agencies;
- 4) we will have created a simplified, uniform registration requirement which can be consistently applied;
- 5) we can even contemplate the creation of computer-generated, automatic billing systems for periodic registration fees; and
- 6) we plan to develop a computer-generated, automatic notice of renewal.

I ask now for your help. A steering committee must ensure the adoption of uniform interpretations in conjunction with these uniform forms so that the simplicity which has been achieved to date will not be eroded.

Such a committee could begin by articulating the relationship of registration requirements between state, federal and self-regulatory agencies.

Such an articulation can, by itself, cause the elimination of much of what we now require.

The committee can also develop a central catalogue -- an index of definitions and interpretations -- a catalogue that would provide comprehensive and accessible sources of data for each of the regulating entities.

The committee can further advise and assist the Commission in promulgating interpretive guidelines. Several areas of the uniform registration form, in particular item 10, have already been the subject of interpretation by the Commission. The states seem to have accepted our interpretations, but we invite you -- in fact we need you -- to begin a more active participation in their formulation.

Our joint goal now must be to seek further simplification and to commit ourselves to ensuring the continued viability of that uniformity which has been achieved to date.

It is easy to regard all of this as a productive but somewhat mundane and colorless bookkeeping effort. I fear many may gently applaud these efforts but not recognize their significance, not merely to a few of us bureaucrats but literally to the very framework of government.

Let me put it in the perspective that I believe it deserves. At no time in our history have we witnessed such antagonism to government regulation. The call for reform -- for retreat -- has never been so widespread or so persistent.

we talk a lot about the lack of faith that has recently been created in the integrity of the government -- a matter that is surely serious -- but integrity can be restored (at least for a time) with the change of a President, a Senator, a Congressman or a Governor. A far more lasting and more corrupting result occurs from what has been the persistent lack of confidence in the capacity of government. I suggest to you with some feeling that we are engaged in an experiment of fundamental importance to show that government can work.

It is in that spirit that I turn to other areas of joint interest which regrettably have been characterized to date by a marked absence of federal-state cooperation. I refer first to the uncoordinated or non-existent regulation of investment advisers, and second to the conflicting approaches adopted by the federal government and an ever-increasing number of states in the regulation of tender offers and takeovers.

The absence of a structure for investment adviser regulation and the obvious lack of uniformity in those rules which do exist, combine to create the worst possible potential for regulatory results. We now face, as we have too often before, a regulatory approach which subjects the public to real abuse from unscrupulous or pitifully inept advisers and at the same time burdens responsible investment advisers with conflicting, uncertain and duplicate regulation.

Consider the present state of affairs:

- A) Registration: 35 of 52 jurisdictions have a registration requirement.
- B) Examinations: 27 jurisdictions authorize the administration of varying types of examination for investment advisers.
- C) Qualifications: 26 jurisdictions provide for qualification of investment advisers by other than examination.
- D) Capital: 18 jurisdictions impose a capital requirement on investment advisers which ranges from \$1,000 to \$25,000.

- E) Bonding: 22 jurisdictions require investment advisers to furnish and maintain a surety bond under certain circumstances.

Here we are faced with a steadily expanding industry in terms of both the number of registered investment advisers and the dollar amount of assets under management. Some estimate that over \$200 billion of assets are now subject to the influence of investment advisers and yet investment advisers are subject to either widely diverse regulatory requirements or none at all.

Consider what we could accomplish without any further legislation by merely extending the cooperative efforts we now have underway. Today, for example, we have the potential for existing state legislation of 27 different types of tests for investment advisers. Surely, the adoption of a standard form of examination is achievable -- one that could be administered nationwide at designated spots and thus permit one such effort to satisfy all agencies that require such testing. A standard format could have variations for states that want also to test local laws.

The adoption of uniform standards are obviously important:



- 1) Investment advisers would be required to be familiar with only a single set of standards, would be assured of consistent interpretations and applicability.
- 2) The utilization of the same standards would establish a foundation for cooperative programs of information-sharing between the Commission and the states.
- 3) The coordination and integration of regulation would eliminate the undue regulatory burden which may not be imposed by the application of diverse standards.

In short, a single format would at once reduce the regulatory burden and increase the regulatory protection. What better test for reform.

The extraordinary and irrefutable point of all of the above is that we have the demonstrated capacity to do this on our own -- we need not be mandated by the federal government, but need accept the more understandable mandate of common sense.

The Commission this year proposed amendments to the Investment Advisers Act primarily for the purpose of initiating a program to achieve the adoption of comprehensive, uniform standards.

For example, prior to adopting any rule requiring an investment adviser to pass a test, the Commission would be required to consult with the appropriate state authorities to avoid unnecessary and redundant regulatory requirements. The Commission would be directed to study unnecessary regulatory duplication to eliminate undue burdens.

Apparently, there is good support for the legislative effort but there has also been considerable criticism in the Congress and the press by those who presume that the authority we seek will be used foolishly. These critics assume far too easily that you and we would seek to establish standards of competence. Perhaps we have only ourselves to blame for these doubts, but let me at least proclaim full support for the point -- we cannot secure and we should not attempt to create, standards to test the competence of advisers.

Obviously there is no logical and consistent method by which to determine an investment adviser's capability of giving good advice. But we can determine that investment advisers are fully aware of the "rules of the game." Is it too much to ask that investment advisers know what the rules are? Also, when an investment adviser does have discretionary control over a client's

money, should we not at least consider the need for minimum capital requirements comparable to those required of broker-dealers?

Most important, as we proceed to make more sense out of our joint surveillance of investment advisers, we can recognize that disclosure is the preferable alternative to complex regulation. Disclosure tells clients something about their advisers, allowing them to make intelligent decisions without imposing arbitrary and useless standards.

I submit that the proposed law is limited and that our ability to administer such laws intelligently has been too firmly certified to dismiss all of this effort as another try for bureaucratic overkill.

The regulation of tender offers presents an even more pressing challenge to our cooperative spirit. That there is a need to create a better balance between established managements and those who seek to change control over corporate assets is apparent. The problem is that each of us is now seeking our own solution. These conflicting approaches adopted at the federal and state levels can only injure the shareholder.

The federal view, as represented by the Williams Act, is that tender offers can be disruptive, but should not be discouraged, because competitive bids have obvious economic benefits to the shareholder.

A tender offer may, for example, improve a company's productivity and prospects by replacing an inefficient management with one that is more able and effective. Tender offers clearly can provide shareholders who are inclined to sell their securities with a higher sale price than is otherwise available in the open market.

Tender offers also serve a useful governance in that the potential of a tender offer encourages management to strive continually for maximum efficiency and profitability.

Similarly, mergers can be an effective means of transferring resources from a firm in a stagnant industry to a firm in a dynamic industry.

Thus, if tender offers were severely circumscribed, these shifts of resources could only be done in a less efficient manner.

All of this is to emphasize the obvious -- takeovers -- friendly or unfriendly -- are part of an efficient market system.

Just criticism, however, has been leveled at the process. The role of brokers and dealers during the offer period can be reexamined. The investment banker who manages the bidding for the acquiring company often enlists the support of brokers in seeking to contact shareholders of the target company. The brokers and their salesmen are compensated by the bidder, usually in the 35 cent to 50 cent range per share, for the shares of individual investors they solicited for the tender offeror. Criticism of the payment of solicitation fees has focused on the alleged harmful consequences of providing an inducement to brokers and salesmen to advise their clients to accept the bidder's offer. On the other hand, one could argue that the information service provided by the brokers may be valued by many shareholders.

Recognizing both the potential benefits and hazards of tender offers, Congress determined to adopt a balanced approach to regulation, favoring neither the management nor the bidder. It sought only to provide more protection to investors, and the other participants in the tender offer process, by removing the traditional cloud of secrecy which had surrounded it.

It is apparent in recent years, however, that an increasing number of states do not agree with the federal approach to the regulation of tender offers. Twenty-one states, including 11 in the past year alone, have enacted legislation which favors management.

These departures from the federal approach occur in various forms:

- (1) Many states have established time-consuming procedures that have no counterpart in the federal law, such as the requirement that there be a cooling-off period of as much as 60 days between the time a tender offer is announced and the time it may actually commence.
- (2) Others compel an extended hearing by a state agency under various circumstances.
- (3) Still others go so far as to defer a tender offer for up to 12 months if the bidder owns at least five percent of the company's stock and failed to inform the persons from whom he bought the stock of his intention to gain control.

The unfairness of this last restriction is emphasized by the fact that it applies even though the offeror may not have had the intent to gain control at the time of the original purchase.

These procedural obstacles all have the effect of significantly delaying a tender offer. Such delays prove to be advantageous to the management, as time is provided within which to limit or destroy much of the shareholder interest that originally may have attached to the offer. The result is contrary to the spirit of the Williams Act, by which Congress intended that the success or failure of a tender offer depend upon the inherent business and economic merits of the offer, rather than purely procedural, and arguably unnecessary, requirements.

An additional area of conflict which exists between the state statutes and the Williams Act is the prescription of inconsistent remedies for tender offer violations. While each of the 21 state statutes forbids conduct which is fraudulent or violative of their requirements for tender offers, 13 of these fail to prescribe any penalties or remedies for violations by the management. Bidders, however, are subject to penalties under all 21 statutes.

Probably the most onerous aspect of the state statutes, however, is their broad applicability. The jurisdictional provisions of the majority of these statutes are couched in language which is broad enough to reach tender offers from several different approaches. One state, for instance, asserts jurisdiction if the target

company is incorporated there, or has its principal place of business there, or has a substantial portion of its assets located there. Frequently, the result of such jurisdictional provisions is that a tender offeror is subjected simultaneously to the overlapping and possibly conflicting laws of more than one state. Obviously, this engenders great confusion and frustration, since theoretically a bidder's actions can comply with the laws of one state, but at the same time violate the laws of another state to which he is also subject.

These conflicts between federal and state law and between the various state laws are indisputably undesirable. Clearly, an overall uniform standard is needed:

- A standard that would provide much needed uniformity.
- A standard that would eliminate the kind of litigation that is now encouraged.
- A standard that most of all will be effective and will finally establish the essential rules of the game.

From the standpoint of the Commission, I can say that we are, of course, firmly committed to the letter and the spirit of the Williams Act which seeks a balanced, even-handed regulatory approach.



For example, the Commission filed an extensive brief with the Supreme Court in the case of Bangor Punta Corporation v. Chris-Craft Industries, Inc, which raises the question of whether in a contest for control of a company, an unsuccessful bidder may recover damages from a competing tender offeror for alleged violations of the Williams Act. We have asked the court to affirm the right to bring such an action. Injured bidders not only have an important interest to protect, but also are often the only persons who are in a position to institute a suit seeking enforcement of the Williams Act. If the court were to bar them from doing so in the future, the effectiveness of the Act would be limited considerably.

More important, the Commission has now proposed rules and schedules for the regulation of tender offers. They are, in the area of their application, extensive and, in our view, would provide a binding uniform set of rules.

The critical point here, one that can test -- but should not test -- our joint spirit of cooperation, is whether these regulations, if finalized by the Commission, will preempt the field of their application and bar state regulations that are in conflict.

As a matter of law, we believe that they will so preempt the field. Indeed, the primary purpose of the Commission in proposing these rules is to preempt such

confusion. The legal argument is simple enough. Congress, in the Williams Act, directed the Commission to design a regulatory approach with respect to tender offers, and any state legislative enactments that conflict with our exercise of that authority must surely give way. But my purpose this morning is not to seek your acquiescence to constitutional dogma, but rather your agreement that there is a need for uniformity. Nor is my purpose this morning to trumpet the wisdom of our proposals in their present form, but rather to seek your cooperation and advice so that the proposals, as finally adopted, will have your understanding and support.

We, of course, promulgated our proposals for comment in the belief that they would improve upon the quality of disclosures now being made in the materials that accompany tender offers and provide, at the same time, sufficient additional protection for investors. And so, we have proposed that all tender offers be kept open for a minimum period of 15 work days and that the withdrawal right be extended from the present seven days to ten work days. We further propose that information concerning tender offers to be furnished to stockholders be considerably expanded. Our tentative judgment is that such proposals will tilt the balance book toward the middle and thus offer a hopefully sufficient protection to the stockholders of a firm that is the subject of a takeover effort.

But, again, let me say with considerable feeling that these proposals can undoubtedly be improved with your thoughtful assistance. The comment period on our proposals does not expire until September 30. I assure you that your views will have our serious consideration and that we will be pleased to make arrangements to have those views presented in any fashion that best suits you. There is no apparent reason why we cannot employ the same spirit of cooperation that produced FOCUS and our Form U-4 to produce rules to govern tender offers that will meet our joint approval.

If we jointly approach the matter from the standpoint of good government rather than as a matter of dry legal principle, we should have no problem deciding that area of regulation that is best served by a uniform federal standard and that area that should be best left to individual state control. We ask for your assistance to find this unanimity, not waving the flag of constitutional compulsion, but rather showing the flag of compelling common sense.

Let me recap -- we are today jointly and individually involved -- like it or not -- in proving both our worth and our capacity for reform. Our responsibility is to define our priorities, resolve our conflicts and prove to ourselves and others the efficacy of our rules.

Effective regulatory reform has never been a glamorous nor an easy task. There are those that prefer the drama of sunset laws that provide a quick execution for all offenders but, surely, intelligent administration can better make the punishment fit the crime.

Goethe told us so many years ago that:

"If each of us sweeps our own  
doorstep the whole world can  
become clean."

The record that we have jointly created this past year suggests that we have a capacity, perhaps unique in government, to produce the housecleaning that will, at least, begin to restore the confidence of the public in the efficacy of government regulation.

Speaking for the Commission, I offer again our full cooperation. I trust we will continue to be responsive to your complaints and I ask that you approach the months ahead with your continued commitment to find paths that are mutually acceptable.