

NEWS

SECURITIES AND EXCHANGE COMMISSION

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REMARKS TO THE
WOMEN'S ECONOMIC CLUB
DETROIT, MICHIGAN
NOVEMBER 20, 1978

"A SKEPTICAL REGULATOR LOOKS AT
THE FUTURE OF REGULATION"

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1.

A WEEK AGO I ATTENDED A BRIEFING FOR KEY GOVERNMENT OFFICIALS BY PRESIDENT CARTER ON THE PRESIDENT'S PROGRAM TO COMBAT INFLATION. I LISTENED TO ALFRED KAHN DISCUSSING THE DIFFERENCES BETWEEN PUBLIC ATTITUDES TOWARD THE ECONOMY DURING THE DEPRESSION OF THE 1930'S AND DURING THE INFLATION OF THE 1970'S. KAHN STATED THAT THE ADMINISTRATION WAS COMMITTED TO ROVING ACROSS GOVERNMENT REGULATORY POLICY AND ELIMINATING UNNECESSARY AND UNREASONABLE BURDENS ON BUSINESS. I WONDERED WHAT GUIDANCE I COULD FIND IN HIS REMARKS FOR MY OWN WORK AS A COMMISSIONER OF THE SEC. AND IT OCCURRED TO ME THAT AS CHAIRMAN OF THE CAB AL KAHN MAY WELL PROVE ONE OF THE MOST COURAGEOUS AND VISIONARY REGULATORS OF OUR DAY BY HAVING ADVOCATED THE ABOLITION OF HIS AGENCY.

NOW I AM NOT HERE TODAY TO RECOMMEND THE ABOLITION OF THE SEC. BUT I SHOULD NOTE THAT AN EARLY VISIONARY CHAIRMAN OF MY AGENCY, WILLIAM O. DOUGLAS, DID ONCE MAKE SUCH A RECOMMENDATION TO PRESIDENT ROOSEVELT. HOWEVER, I AM HERE TODAY TO RECOMMEND A SKEPTICAL ANALYSIS OF OUR INDEPENDENT FEDERAL REGULATORY AGENCIES. I AM SKEPTICAL OF BOTH THE CONTINUING RELEVANCE OF CERTAIN OF THE PHILOSOPHICAL BELIEFS WHICH LED TO THE CREATION OF SUCH AGENCIES, AND THE MECHANISMS BY WHICH SUCH AGENCIES ENDEAVOR TO ACHIEVE THEIR STATUTORY OBJECTIVES.

2.

IT WOULD BE APPROPRIATE AT THE OUTSET OF THIS TALK TO NOTE THAT SKEPTICISM IS THE DOCTRINE THAT ALL KNOWLEDGE MUST ALWAYS BE IN QUESTION AND THAT INQUIRY MUST BE A PROCESS OF DOUBTING. I BELIEVE THAT SKEPTICISM IS AN ESPECIALLY HEALTHY TRAIT FOR REGULATORY OFFICIALS WHO DEAL IN THE TECHNICALITIES OF OFTEN ARCANE STATUTES.

THE PUBLIC GENERALLY IS UNFAMILIAR WITH THE DETAILS OF OUR WORK AND DOES NOT KNOW HOW, IF AT ALL, IT IS BENEFITED FROM WHAT WE DO. FURTHER, THE PUBLIC IS GENERALLY UNAWARE OF THE DIRECT AND INDIRECT COSTS OF THE REGULATORY BURDENS WE IMPOSE. A BAD REGULATORY DECISION RARELY EVOKES PUBLIC RESPONSE. AND, CONGRESS, WHICH FACES AN INCREDIBLE OVERSIGHT BURDEN, CAN REMEDY ONLY THE MOST EGREGIOUS REGULATORY MISTAKES. TO A LARGE EXTENT, THEREFORE, REGULATORS MUST RELY ON THEIR OWN DEVICES IN DEFINING THE PUBLIC INTEREST.

I SUGGEST THAT SKEPTICISM OR SELF-QUESTIONING IS ONE WAY THAT REGULATORS CAN COMPENSATE FOR WHAT FREQUENTLY IS A LACK OF CONTINUING PUBLIC SUPERVISION. UNFORTUNATELY, MOST OF US WOULD RATHER CONGRATULATE OURSELVES ON OUR ACCOMPLISHMENTS AND DENY OUR ERRORS.

DURING THE LAST FEW YEARS, THERE HAS BEEN A CHANGING PUBLIC PERCEPTION OF GOVERNMENT'S ROLE IN OUR SOCIETY, WHICH I BELIEVE WILL PROFOUNDLY AFFECT THE FUTURE OF REGULATION. IN 1962, JUDGE HENRY FRIENDLY, A DISTINGUISHED JURIST AND LEGAL THINKER, STATED --

"THE IDEA THAT WE CAN OVERCOME THE DIFFICULTIES OF THE ADMINISTRATIVE AGENCIES BY ABOLISHING OR EVEN SERIOUSLY CURTAILING THE AMOUNT OF REGULATION IS A MIRAGE. . . . CHANGES THERE WILL SURELY BE, BUT AS THE YEARS GO BY WE ARE MORE LIKELY TO HAVE MORE REGULATION THAN LESS." 1/

JUDGE FRIENDLY'S PREDICTION, WHICH PROBABLY PROVED TRUE IN THE SHORT RUN, MAY NO LONGER BE APPROPRIATE. AS PROFESSOR GEOFFERY HAZARD OF THE YALE LAW SCHOOL NOW NOTES --

"WE ARE IN AN AGE OF DIMINISHED REFORM EXPECTATIONS AND GREATER SKEPTICISM ABOUT THE USES OF GOVERNMENT INTERVENTION." 2/

MOST TELLING OF ALL ABOUT THIS AGE OF DIMINISHED EXPECTATIONS IS THAT THE CARTER PRESIDENCY, UNLIKE PRIOR DEMOCRATIC ADMINISTRATIONS OF MY LIFETIME, HAS NOT ADOPTED A UTOPIA-INVOKING SLOGAN -- SUCH AS NEW DEAL, FAIR DEAL, NEW FRONTIER, OR GREAT SOCIETY.

THE REASONS FOR THIS CHANGING PUBLIC ATTITUDE CONCERNING GOVERNMENTAL REGULATION ARE VARIED AND COMPLEX. FOR OVER FOUR DECADES, A LIBERAL PHILOSOPHY, BORN IN THE GREAT DEPRESSION HAS GOVERNED THE AMERICAN POLITICAL ESTABLISHMENT. ITS ADHERENTS HAVE DOMINATED THE CONGRESS AND GENERALLY CONTROLLED THE PRESIDENCY. BUT, DURING THE LAST FEW YEARS SOME OF THOSE ADHERENTS - AND I INCLUDE MYSELF AMONG THEM - HAVE BEGUN TO CHALLENGE THE TRADITIONAL LIBERAL AXIOMS AND TO QUESTION WHETHER AMERICA SHOULD CONTINUE TO BE GOVERNED

1/ STIGLER AND COHEN, "CAN REGULATORY AGENCIES PROTECT THE CONSUMER?" 42-43 (1971).

2/ FALK, "A SUIT OVER THE LOSS OF PRIVATE PENSION BENEFITS IS ONE ISSUE BEFORE SUPREME COURT IN NEW TERM," WALL STREET JOURNAL, 48 (SEPT. 28, 1978) /EMPHASIS ADDED/.

BY THE POLICIES CONCEIVED IN THE EMERGENCY LEGISLATION OF ROOSEVELT'S HUNDRED DAYS. THE ECONOMIC AND SOCIAL EXPECTATIONS LAST RAISED IN THE CALL FOR A GREAT SOCIETY OF THE 1960'S WERE LEFT UNSATISFIED TO CREATE A LEGACY OF DISAPPOINTED IDEALISM. AND, THE FAILURE OF THESE SOCIAL PROGRAMS, DESPITE THE MONEY, EFFORTS AND ENERGIES INVESTED, LED TO A SKEPTICISM ABOUT THE GOVERNMENT'S ABILITY TO ACHIEVE EVEN POPULARLY ACCLAIMED GOALS. MOREOVER, THE FINANCIAL COLLAPSE OF NEW YORK CITY, IN MANY RESPECTS OUR MOST POLITICALLY LIBERAL GOVERNMENT, RAISED SERIOUS QUESTIONS ABOUT HOW REFORM CAN BE FINANCED.

THEREFORE, QUESTIONING LIBERALS, WHO SEEK SOLUTIONS TO SOCIETY'S CRITICAL PROBLEMS, FIND OURSELVES IN THE MOST UNCOMFORTABLE OF SITUATIONS. WE NO LONGER ASSUME THAT OUR COUNTRY, OR EVEN THE WORLD, HAS UNLIMITED NATURAL RESOURCES. ALTHOUGH WE NO LONGER HAVE UNQUESTIONING CONFIDENCE IN GOVERNMENT'S ABILITY TO SOLVE PROBLEMS, WE DO NOT ASSUME THAT THE PRIVATE SECTOR HAS THE CAPACITY OR IMAGINATION TO SOLVE OUR SOCIAL OR ECONOMIC PROBLEMS. INDEED, MANY LIBERALS HAVE BEEN NURTURED ON A DISTRUST OF BUSINESS. GOVERNMENT AND BUSINESS HAVE GENERALLY REGARDED ONE ANOTHER AS ADVERSARIES IN THE REGULATORY SCHEME. TRADITIONAL LIBERALS ARE MORE LIKELY TO THINK THAT BUSINESS HAS COOPTED THE GOVERNMENT'S REGULATORS, THAN TO WONDER WHETHER GREATER FREEDOM FOR THE BUSINESS COMMUNITY WOULD ENHANCE THE PUBLIC WELFARE.

5.

I SUSPECT THAT I DO NOT HAVE TO CONVINCE YOU THAT WE ARE IN A PERIOD OF ECONOMIC DIFFICULTY. THE AXIOMS OF THE GREAT DEPRESSION DO NOT APPEAR WIDELY ACCEPTED IN THESE INFLATIONARY TIMES. THE DEPRESSION WAS PERCEIVED AS SOCIALLY UNJUST BECAUSE THERE WAS SUCH WIDESPREAD POVERTY AND UNEMPLOYMENT IN A LAND OF UNLIMITED OPPORTUNITY. IN ROOSEVELT'S ERA, THE CAUSE OF THE ECONOMIC CRISIS WAS PERCEIVED TO BE BUSINESS, AND GOVERNMENT REGULATION WAS SEEN AS A WAY TO READJUST UNFAIR DISTRIBUTIONS OF WEALTH.

IN CONTRAST, TODAY THE PROBLEM IS INFLATION, WHICH IS ALSO PERCEIVED AS SOCIALLY UNJUST BECAUSE THE INCOMES, GOODS AND SERVICES OF A LIMITED ECONOMY ARE NOT BEING FAIRLY DISTRIBUTED. BUT GOVERNMENT REGULATION IS PERCEIVED AS PART OF THE PROBLEM RATHER THAN AN OBVIOUS SOLUTION. AS THE COMMISSION'S CHAIRMAN, HAROLD M. WILLIAMS, RECENTLY ANALYZED --

"INFLATION -- WIDELY CHARACTERIZED AS OUR MOST PRESSING PROBLEM -- IS PRIMARILY A POLITICAL PHENOMENON. AT BOTTOM, ITS CAUSE IS THE FAILURE OF OUR POLITICAL SYSTEM TO CONTAIN THE GROWTH OF SOCIAL DEMANDS WITHIN LIMITS TOLERABLE TO THE MARKET." 3/

CHAIRMAN WILLIAMS BELIEVES THAT WHILE WE PERMIT THE POLITICAL PROCESS TO IMPOSE NECESSARY EGALITARIANISM ON THE MARKET, THERE IS NO CORRESPONDING MECHANISM WHICH ENCOURAGES THE POLITICAL PROCESS TO CONSIDER THE IMPACT OF ITS ACTIONS ON THE ECONOMY. THUS, HE CONCLUDES THAT --

3/ WILLIAMS, "EGALITARIANISM AND MARKET SYSTEMS"
(SEPT. 26, 1978), P. 21.

"IN THE INTERESTS OF EQUALITY AND FAIRNESS, WE ARE BECOMING SO ENMESHED IN REGULATION THAT WE MAY HOBBLE, RATHER THAN RESHAPE, OUR INSTITUTIONS -- WHETHER THEY BE BUSINESS, THE COMMUNITY, THE UNIVERSITY, OR WHATEVER." ^{4/}

MUCH REGULATORY LEGISLATION WAS INTENDED TO PROVIDE THE PUBLIC, AND ESPECIALLY CONSUMERS, WITH PROTECTION AGAINST PERCEIVED ILLS. IN MANY INSTANCES WE MUST REASSESS NOT ONLY THE EFFICACY OF THAT PROTECTION, BUT ALSO WHETHER, THE ECONOMIC, LEGAL AND SOCIAL BURDENS OF MAINTAINING THIS LEGISLATIVE INSURANCE ARE WORTH SUCH PROTECTION. ALL REGULATION IS COSTLY, NOT ONLY BECAUSE IT IS PAID FOR BY TAXATION, BUT ALSO BECAUSE IT INTERFERES WITH MARKET FORCES, INCREASES THE SIZE AND COMPLEXITY OF GOVERNMENT, AND FAVORS ONE GROUP OF PEOPLE IN OUR SOCIETY OVER ANOTHER. IN MANY INSTANCES THE FAVORED GROUP NEEDS SPECIAL CONSIDERATION OR PROTECTION. BUT OFTEN, THE CLAIMS OF THE PROTECTED ARE NO BETTER THAN THE CLAIMS OF THE REGULATED. FURTHER, THE PROTECTED AND THE REGULATED MAY TURN OUT TO HAVE A CERTAIN MUTUALITY OF IDENTITY SO THAT THE PRIMARY BENEFICIARIES OF A REGULATORY SCHEME ARE THE REGULATORS.

THIS MEANS THAT EVEN AN ACCEPTANCE OF THE THEORY THAT REGULATION IS A MAJOR CONTRIBUTOR TO INFLATION WILL NOT NECESSARILY RESULT IN ANY DISMANTLING OF THE REGULATORY APPARATUS. THE FEDERAL BUREAUCRACY IS A POWERFUL SPECIAL INTEREST GROUP BECAUSE IT BENEFITS MANY OTHER INFLUENTIAL INTERESTS. IN THE WORDS OF LOUIS KOHLMEIER, AN INSIGHTFUL

^{4/} Id. p. 20.

OBSERVOR OF THE REGULATORY SCENE:

"EVERY FEDERAL REGULATORY SYSTEM HAS ITS POLITICAL CONSTITUENCY -- ORGANIZED LABOR, FARMERS, ENVIRONMENTALISTS, BUSINESS INTERESTS AND OTHER POLITICALLY POWERFUL GROUPS. TO SUGGEST, AS THE THEORY DOES, THAT COSTS OUTWEIGH BENEFITS OF REGULATION AND THAT REGULATION THUS IS A ROOT CAUSE OF INFLATION CHALLENGES NOT ONLY A LARGE SLICE OF AMERICAN HISTORY BUT MANY OF THE COUNTRY'S MOST INFLUENTIAL SPECIAL INTERESTS." 5/

AT THE PRESENT TIME I AM A PUBLIC OFFICIAL -- A FEDERAL REGULATOR. HOWEVER, BY PROFESSION I AM AN ATTORNEY, AND I HAVE DEVOTED MOST OF MY CAREER TO THE PRACTICE OF SECURITIES LAW, A SPECIALTY WHICH WOULD NOT EXIST WITHOUT THE SEC. A RECENT COMMISSION OF THE AMERICAN BAR ASSOCIATION, IN A STUDY, WHICH I WILL DISCUSS IN SOME DETAIL LATER, NOTES THE ROLE OF THE LEGAL PROFESSION IN THE REGULATORY PROCESS AS FOLLOWS:

LAWYERS HAVE BEEN MAJOR PARTICIPANTS IN THE DEVELOPMENT AND OPERATION OF OUR PRESENT SYSTEM OF GOVERNMENT REGULATION. THEY HAVE HELPED TO WRITE AND ENACT THE UNDERLYING LEGISLATION THAT CREATED AND GRANTED POWER TO REGULATORY AGENCIES. LAWYERS HAVE LED THE DEFENSE OF, AS WELL AS THE ATTACK ON, THE CONSTITUTIONALITY OF LEGISLATIVE DELEGATIONS OF REGULATORY POWER. THE STAFFING OF REGULATORY AGENCIES AND COMMISSIONS, AT ALL LEVELS, HAS IMPORTANTLY INVOLVED LAWYERS, AND THE REPRESENTATION OF REGULATED AND AFFECTED INTERESTS BEFORE THE AGENCIES IS PERFORMED BY LAWYERS. THE LEGAL PROFESSION THUS SHARES RESPONSIBILITY FOR THE BETTER FUNCTIONING OF THE REGULATORY SYSTEM. THIS IS ESPECIALLY TRUE IN THE FACE OF STRONG INDICATIONS THAT THE REGULATORY APPARATUS IS NOT WORKING WELL BUT IS CONTINUING TO EXPAND. 6/

5/ KOHLMEIER, "NEW ANALYSES OF REGULATION AS FUNDAMENTAL INFLATION CAUSE", FINANCIER P. 12 (SEPT. 1978).

6/ AMERICAN BAR ASSOCIATION COMMISSION ON LAW AND THE ECONOMY, "FEDERAL REGULATION: ROADS TO REFORM" PP. 10-11 (EXPOSURE DRAFT 1978).

AS A LAWYER, I AM DEEPLY DISTRESSED ABOUT WHAT SOMETIMES LOOKS LIKE AN ALLIANCE BETWEEN THE REGULATORY AGENCIES AND THE REGULATED INDUSTRIES FOR THE BENEFIT OF THE LEGAL PROFESSION INSTEAD OF THE PUBLIC. I DO NOT BELIEVE THIS ALLIANCE IS THE RESULT OF MALEVOLENCE OR CONSPIRACY. RATHER, IT IS AN UNFORTUNATE FALL OUT OF TOO MUCH GOVERNMENT REGULATION BY AN OVERLY LEGALISTIC SOCIETY.

LET ME TURN FROM A GENERAL DIATRIBE AGAINST REGULATION TO THE PROBLEMS OF MY OWN AGENCY AND MY OWN WORK AS A PUBLIC OFFICIAL. THE SEC HAS LONG ENJOYED THE REPUTATION IN GOVERNMENT CIRCLES AS THE PREMIER REGULATORY AGENCY. OUR STAFF HAS A REPUTATION AS BEING SMART, DEDICATED, AGGRESSIVE, AND SINGLE-MINDED IN EXECUTING OUR MANDATE, WHICH IS, PROTECTING THE PUBLIC INVESTOR AND MAINTAINING FAIR AND ORDERLY SECURITIES MARKETS. BUT, WHAT DOES THE PUBLIC INVESTOR THINK OF ITS CHAMPION ON WALL STREET? A RECENT INDEPENDENT SURVEY COMMISSIONED BY THE NEW YORK STOCK EXCHANGE FOUND THAT 64% OF POLLED STOCKHOLDERS WHO MADE AT LEAST SIX TRADES THE PRECEDING YEAR VIEWED THE SEC UNFAVORABLY.

I AM NOT CERTAIN OF THE SIGNIFICANCE OF THAT STATISTIC. DOES IT MEAN THAT THE SEC HAS BEEN INEFFECTIVE? OR, THAT WE ARE UNNECESSARY? HAVE WE ENGAGED IN TOO MUCH REGULATION OR TOO LITTLE? CERTAINLY, AS GOVERNMENT ADMINISTRATORS, WE CANNOT IGNORE OUR PUBLIC'S PERCEPTIONS AS WE MAKE TODAY THE DECISIONS THAT WILL DETERMINE TOMORROW'S REGULATORY STRUCTURE. WE MUST REMEMBER THAT THE SHAREHOLDERS WE PROTECT AGAINST FRAUD BY REGULATING BUSINESS ALSO PAY THE COSTS OF THAT REGULATION IN DECREASED DIVIDENDS AND PROFITS.

THIS BRINGS ME TO A MAJOR FRUSTRATION OF MINE, AS A SKEPTICAL ADMINISTRATOR WHO HAS TO MAKE REGULATORY DECISIONS -- THE LACK OF SOURCES COMPETENT TO PROVIDE ANSWERS TO ONE'S INQUIRIES CONCERNING THE WORKINGS OF THE REGULATORY PROCESS. IT IS MOST REMARKABLE THAT -- DESPITE THE AWESOME POWER OF THE BUREAUCRACY AND ITS SIGNIFICANT IMPACT ON OUR NATIONAL WAY OF LIFE -- THERE IS A DEARTH OF SERIOUS INQUIRIES INTO THE FEDERAL REGULATORY PROCESS. TO A LARGE EXTENT, TODAY'S REFORM MINDED REGULATOR HAS TO PROCEED BY TRIAL AND ERROR.

HOWEVER, RECENTLY THERE HAVE BEEN TWO VERY SIGNIFICANT STUDIES ON FEDERAL REGULATION. THE FIRST IS AN EXPOSURE DRAFT PREPARED BY THE AMERICAN BAR ASSOCIATION'S COMMISSION ON LAW AND THE ECONOMY, WHICH I REFERRED TO PREVIOUSLY. I WILL CALL THIS THE ABA STUDY. THE SECOND IS THE SENATE COMMITTEE ON GOVERNMENTAL AFFAIRS' STUDY IN FEDERAL REGULATION -- WHICH I WILL CALL THE SENATE STUDY. //

WHAT THESE STUDIES SHOW IS THAT DIFFERENCES EXIST AMONG REGULATORY AGENCIES BOTH IN OBJECTIVES AND REGULATORY TECHNIQUES. FURTHER, SOME AGENCIES ARE CONSIDERED BETTER THAN OTHERS -- AT LEAST IN PART -- BECAUSE OF THE FORTUITY OF HAVING A MANDATE WHICH IS ACHIEVABLE WITHIN THE REGULATORY STRUCTURE PROVIDED. I WOULD LIKE TO DISCUSS HOW, TO A CERTAIN EXTENT, THE SEC HISTORICALLY HAS BEEN A BENEFICIARY OF THIS HAPPENSTANCE. NEVERTHELESS, RISKS TO OUR ABILITY TO FUNCTION EFFECTIVELY IN THE FUTURE EXIST.

// COMMITTEE ON GOVERNMENTAL AFFAIRS, UNITED STATES SENATE, "STUDY ON FEDERAL REGULATION" (1977) AT VOL. V CHAPTER 3.

THE ABA STUDY IS BASED ON A DISQUIETING CONCERN OVER THE UNCHECKED AND POSSIBLY UNCONTROLLABLE GROWTH OF FEDERAL REGULATION AND AN ACCEPTANCE OF THE REALITY AND VALUES OF A MIXED ECONOMY. THE STATED OBJECTIVE OF THE STUDY'S RECOMMENDATIONS IS TO MAXIMIZE THE BENEFITS OF SUCH A MIXED ECONOMY FOR ALL CITIZENS THROUGH MORE INTELLIGENT AND SOPHISTICATED USE OF THE INSTRUMENTS OF GOVERNMENT INTERVENTION. THE STUDY CONTAINS AN EXCELLENT ANALYSIS OF REGULATORY TECHNIQUES. IT DIVIDES "CLASSICAL REGULATION" INTO THREE TYPES: (1) PRICE REGULATION; (2) ALLOCATION REGULATION, SUCH AS LICENSING; AND (3) STANDARD SETTING REGULATION, SUCH AS POLLUTION CONTROLS. BUT, THE ABA STUDY ALSO PROPOSES SOME ALTERNATIVES TO "CLASSICAL REGULATION". THESE INCLUDE: COMPETITIVE MARKETS SUPPORTED BY STRONG ANTITRUST LAWS; DISCLOSURE REQUIREMENTS; TAXATION, BOTH AS A CARROT AND A STICK; AND COLLECTIVE BARGAINING. IN GENERAL, THE STUDY RECOMMENDS THE SUBSTITUTION OF ECONOMIC INCENTIVES AND DISINCENTIVES FOR CLASSICAL TYPES OF REGULATION.

AS I READ THE ABA STUDY WITH THE OBVIOUS FOCUS OF AN SEC COMMISSIONER, I NOTED MY AGENCY'S GOOD FORTUNE. HISTORICALLY, THE COMMISSION HAS BEEN AN AGENCY WHOSE PRIMARY MISSION WAS TO ENCOURAGE DISCLOSURE. UNLIKE MOST OTHER FEDERAL REGULATORY AGENCIES WE WERE NOT PREOCCUPIED WITH RATEMAKING OR DISTRIBUTING SCARCE RESOURCES, OR SETTING STANDARDS OF BUSINESS CONDUCT. DISCLOSURE IS AN ACHIEVABLE MANDATE.

NEVERTHELESS, AS A SKEPTICAL REGULATOR IT CROSSED MY MIND THAT GOVERNMENT MANDATED DISCLOSURE CAN BE ANALYZED AS STANDARD SETTING REGULATION. FURTHERMORE, IT CAN BE A REAL BURDEN ON COMPETITION. ALTHOUGH THE SECURITIES LAWS WERE ENVISIONED AS A MECHANISM FOR COMPELLING CORPORATIONS TO TAKE THE RESPONSIBILITY FOR FULLY DISCLOSING THEIR AFFAIRS, THE SEC HAS INCREASINGLY ASSUMED THE RESPONSIBILITY FOR DICTATING TO CORPORATIONS EXACTLY WHAT AND HOW TO DISCLOSE. FURTHER, THE PROBLEMS ARISING FROM ENFORCEMENT BY A GOVERNMENT PROSECUTOR OF STANDARDS, NOTED BY THE ABA STUDY, ARE PRESENT IN THE COMMISSION'S ENFORCEMENT OF OUR DISCLOSURE REQUIREMENTS.

IT SEEMS TO ME THAT AFTER 45 YEARS WE MUST REEXAMINE THE PREMISES UPON WHICH THE SEC'S DISCLOSURE POLICY IS BASED AS WELL AS THE REGULATORY TECHNIQUES BY WHICH WE IMPLEMENT THAT POLICY. I THINK WE MUST BE MORE SENSITIVE TO THE BURDENS OF REGULATION AND MORE CREATIVE IN TRYING TO ACHIEVE REGULATORY OBJECTIVES BY NEW METHODS.

READING THE SENATE STUDY ALSO INITIALLY ALLAYED MY CONCERNS ABOUT THE SEC'S REGULATORY PROGRAMS. THE SENATE STUDY EXAMINED THE TENSIONS BETWEEN PROMOTIONAL AND REGULATORY ACTIVITIES. LET ME EXPLAIN THESE IMPORTANT CONCEPTS. PROMOTIONAL ACTIVITIES ARE THOSE DESIGNED TO BENEFIT OR FOSTER PRIVATE BUSINESS GROWTH OR DEVELOPMENT.

AN EXAMPLE OF A PROMOTIONAL MANDATE WOULD BE THE CAB'S CHARGE "TO ENCOURAGE AND FOSTER THE DEVELOPMENT" OF AIR TRANSPORTATION. IN CONTRAST, AS USED IN THE SENATE STUDY, REGULATORY ACTIVITY MEANS LAW ENFORCEMENT WORK. THE STUDY FOUND THAT, WHERE PROMOTIONAL ACTIVITIES EXIST SIDE-BY-SIDE WITH REGULATORY ACTIVITIES, THERE IS A TENDENCY FOR PROMOTION TO PREDOMINATE. AN AGENCY CHARGED WITH PROMOTING A PARTICULAR INDUSTRY OR BUSINESS ACTIVITY IS HESITANT TO REGULATE IT AGGRESIVELY.

HISTORICALLY, THE SEC HAS HAD A VERY MINOR PROMOTIONAL ROLE. IN ALMOST THE EXCLUSIVE ROLE OF POLICEMAN OF THE CAPITAL MARKET, THE COMMISSION HAS BEEN INSULATED FROM THE TENSIONS OF THE PROMOTIONAL-REGULATORY DICHOTOMY.

NOW THE SKEPTICAL LISTENER MAY HAVE NOTED THAT WHEN I EXTOLLED THE COMMISSION'S GOOD FORTUNE, I REFERRED TO OUR "HISTORICAL" ROLE. IN 1975, CONGRESS GAVE THE COMMISSION NEW MANDATES BEYOND OUR TRADITIONAL ENFORCEMENT RESPONSIBILITIES. CONGRESS DETERMINED THAT OUR "SECURITIES MARKETS ARE AN IMPORTANT NATIONAL ASSET WHICH MUST BE PRESERVED AND STRENGTHENED." ACCORDINGLY, IT DIRECTED THE COMMISSION TO USE ITS AUTHORITY TO FACILITATE THE ESTABLISHMENT OF A NATIONAL MARKET SYSTEM FOR SECURITIES. THAT GAVE US AN UNACCUSTOMED PROMOTIONAL ROLE. SIMILARLY, WE WERE INSTRUCTED TO FACILITATE THE ESTABLISHMENT OF A NATIONAL SECURITIES CLEARING SYSTEM. THE MEANS BY WHICH WE MUST ACCOMPLISH THESE NEW MANDATES ARE GENERALLY BY CLASSICAL REGULATORY TECHNIQUES, SUCH AS RATEMAKING, LICENSING AND STANDARD-SETTING.

IN OTHER WORDS, JUST WHEN DUAL PROMOTIONAL-REGULATORY MANDATES AND MANY REGULATORY PROCEDURES HAVE COME INTO INCREASING QUESTION, THE SEC IS SIGNIFICANTLY MOVING INTO THESE AREAS FOR THE FIRST TIME. WE ARE NOW FACING SOME OF THE REGULATORY PITFALLS WITH WHICH OTHER AGENCIES HAVE STRUGGLED FOR DECADES.

HOPEFULLY, WE CAN LEARN FROM THE EXPERIENCES OF OTHERS. FOR EXAMPLE, WE RECOGNIZE THAT OUR PROSECUTORIAL CAPABILITY MUST NOT BE COMPROMISED BY OUR NEW PROMOTIONAL FUNCTIONS. NEVERTHELESS, I BELIEVE THAT THESE NEW ROLES PRESENT THE COMMISSION WITH A GRAVE CHALLENGE TO ITS FUTURE ROLE AS A CREDIBLE AND EFFECTIVE REGULATORY AGENCY.

CREDIBILITY AND EFFECTIVENESS ARE, AFTER ALL, IMPORTANT TESTS OF AN AGENCY'S MERIT. TO BE CREDIBLE, IT MUST EARN THE RESPECT BOTH OF THE PUBLIC AND THE INDUSTRY WHICH IT REGULATES. TO BE EFFECTIVE, IT MUST EXERCISE GOOD JUDGMENT.

AND SOMETIMES GOOD JUDGMENT REQUIRES AN APPRECIATION OF CHANGING VALUES AND PERCEPTIONS IN OUR MODERN ECONOMY. I BELIEVE THAT ONE CHANGED PERCEPTION OF TODAY IS RECOGNITION OF THE LIMITS OF GOVERNMENT INTERVENTION. I ENDORSE ALFRED KAHN'S PARTING ADVICE TO HIS SUCCESSOR AT THE CAB, WHICH WAS --

"UNDERSTAND HOW A FREE MARKET WORKS AND RESTRAIN ONE'S TENDENCY TO MEDDLE." ^{8/}

8/ TIME (NOVEMBER 6, 1978) P. 22.

IN ORDER TO SOUND A MORE HOPEFUL NOTE THAN I HAVE STRUCK IN MUCH OF THIS TALK, I WOULD LIKE TO MENTION ONE OF THE COMMISSION'S RECENT DE-REGULATORY EFFORTS. ONE OF THE STATUTES WE ADMINISTER--THE INVESTMENT COMPANY ACT, UNDER WHICH THE SEC REGULATES MUTUAL FUNDS AND OTHER INVESTMENT COMPANIES--IS NOTORIOUS BOTH FOR ITS INHERENT COMPLEXITY AND THE BYZANTINE GLOSS WHICH THE COMMISSION'S INTERPRETATIONS ADDED. BECAUSE OF THE INDUSTRY'S DIFFICULTY IN DETERMINING WHETHER ANY PARTICULAR NOVEL ACTION IS LEGAL, MANAGEMENT LACKED CONFIDENCE TO PROCEED WITH ANY INNOVATION ABSENT OUR STAFF'S APPROVAL. SLOWLY, BUT SURELY, THE FINAL WORD ON CONVENTIONAL BUSINESS DECISIONS PASSED FROM THE PRIVATE SECTOR TO A GOVERNMENTAL AGENCY. THE COMMISSION HAS RECOGNIZED THAT THIS IS NOT A HEALTHY SITUATION--FOR US, FOR THE INDUSTRY, OR FOR THE PUBLIC.

SO WE HAVE FORMED A SPECIAL STUDY FOR THE PURPOSE OF REVISITING THE REGULATORY SCHEME APPLICABLE TO INVESTMENT COMPANIES. WE WILL TRY TO MAKE THESE RULES MORE UNDERSTANDABLE, CHEAPER TO COMPLY WITH, AND TO SHIFT THE BURDENS OF CONVENTIONAL BUSINESS DECISIONS BACK TO THE INVESTMENT COMPANY'S DIRECTORS--WHERE SUCH RESPONSIBILITIES SHOULD REST. HOPEFULLY, THIS IS JUST A FIRST STEP IN MAKING THE COMMISSION'S REGULATIONS MORE RATIONAL.

NONETHELESS, JUST AS GOVERNMENT REGULATION HAS NOT PROVEN A PANACEA FOR SOCIETY'S PROBLEMS, NEITHER SHOULD THE GOVERNMENT'S RETHINKING OF ITS REGULATORY FUNCTIONS CREATE

UNDUE EXPECTATIONS. TO REMOVE GOVERNMENT FROM THE MARKET-PLACE ALSO HAS ITS SOCIETAL COSTS. MANUEL F. COHEN A FORMER SEC CHAIRMAN BELIEVED THAT --

/REGULATION IS ESSENTIAL TO PRESERVE AND ENFORCE COMPETITION AND TO ENSURE THAT THE MARKETPLACE OPERATES IN THE PUBLIC INTEREST. ... THE LAW OF THE JUNGLE WHERE ONLY THE BIGGEST, THE MOST SOPHISTICATED, OR THE MOST UNSCRUPULOUS SURVIVE IS INCONSISTANT WITH OUR DEMOCRATIC ETHIC OF EQUALITY BEFORE THE LAW AND IN OUR DAILY TASKS AND EFFORTS. 9/

THERE IS NO QUESTION THAT DE-REGULATION IS NOT NECESSARILY WHOLLY GOOD. AN OBVIOUS EXAMPLE IS THAT NONE OF US WOULD WANT THE PURE FOOD AND DRUG LAWS REPEALED WITH A RETURN TO THE FOOD PROCESSING METHODS DESCRIBED IN SINCLAIR LEWIS' NOVEL THE JUNGLE. FURTHER, EVEN DE-REGULATORY EFFORTS WHICH ARE WORTHWHILE CAN CAUSE SEVERE AND IN SOME WAYS ADVERSE DISLOCATIONS. AN EXAMPLE VERY CLOSE TO HOME IS THE DECISION BY THE SEC TO ORDER THE STOCK EXCHANGES TO END FIXED COMMISSION RATES -- THAT IS, TO ALLOW COMPETITION AND THE MARKETPLACE TO DETERMINE COMMISSION RATES. THIS OCCURRED IN MAY 1975.

I BELIEVE THAT THE COMMISSION'S ACTION WAS ALTOGETHER PROPER. BUT, IT DID SET IN MOTION SOME UNDESIRABLE ECONOMIC FORCES. THE COMMISSION RATES PAID BY THE LARGE INSTITUTIONS DROPPED PERCEPTUOUSLY -- OFTEN TO LESS THAN HALF THE OLD RATE. WHILE MANY INSTITUTIONS ARE FIDUCIARIES AND HAVE PASSED THESE SAVINGS ON TO THEIR CUSTOMERS, OTHERS, PARTICULARLY FOREIGN FINANCIAL INSTITUTIONS, HAVE NOT. IN CONTRAST TO LOWERED INSTITUTIONAL RATES, THE COMMISSION RATES PAID BY THE INDIVIDUAL INVESTOR AT FULL SERVICE BROKERAGE HOUSES GENERALLY INCREASED MARKEDLY. SOME COMMENTATORS BELIEVE

THAT THESE HIGHER RATES ARE A FACTOR KEEPING THE INDIVIDUAL INVESTOR OUT OF THE MARKET AT A TIME WHEN OUR NATION NEEDS EVERY POSSIBLE SOURCE OF CAPITALIZATION. MOREOVER, THE ECONOMIC PRESSURES OF UNFIZED COMMISSION RATES HAVE LED TO INCREASING MERGERS IN THE SECURITIES INDUSTRY.

IF REGULATION IS TO HAVE A VIABLE AND WORTHWHILE FUTURE, I BELIEVE THAT REGULATORS MUST AVOID A PREOCCUPATION WITH NARROW MANDATES FOR SPECIFIC PUBLIC INTEREST GROUPS, AND CONSIDER THE MORE GENERAL PUBLIC WELFARE IN THE CONTEXT OF OUR TOTAL ECONOMY. IN THE CASE OF THE SEC, THIS MEANS THAT WE MUST CONSIDER OUR STATUTORY MANDATE TO ACT IN THE PUBLIC INTEREST, AS WELL AS OUR MANDATE TO FURTHER INVESTOR PROTECTION.

LET ME GIVE YOU AN EXTREME EXAMPLE. THE SEC'S MOST OBVIOUS MANDATE IS TO SUPPRESS FRAUD IN THE SECURITIES MARKETS. THE LESS FRAUD, THE LESS EMBARRASSING CONGRESSIONAL INQUIRIES, THE LESS BAD PRESS, THE BETTER OUR PUBLIC RELATIONS POSTURE. OF COURSE, IT IS OFTEN HARD TO CONVINCe PEOPLE THAT NO FRAUD IS INVOLVED WHEN AN INVESTMENT FAILS. So, IT IS IN SOME RESPECTS IN OUR INSTITUTIONAL SELF-INTEREST NOT TO ENCOURAGE RISKY INVESTMENTS. WE CAN CHILL RISK BY A POLICY OF PRESUMING FRAUD WHENEVER INVESTMENT VEHICLES DO NOT ACHIEVE INTENDED RESULTS. WE CAN CHILL RISK BY TRANSFORMING ALL INVESTMENT VEHICLES INTO INSURANCE POLICIES FOR THE INVESTOR.

RATHER THAN HAVE THE HEAVY SHADOW OF GOVERNMENT INVESTIGATORS BEHIND THEM, PROMOTORS WOULD REFRAIN FROM MARKETING SPECULATIVE SECURITIES. BUT, THE AMERICAN ECONOMY NEEDS RISK TAKERS TO DEVELOP NEW PRODUCTS, DISCOVER NEW RESOURCES, AND CREATE NEW JOBS. WE, AS AN AGENCY, MUST BALANCE OUR OWN INSTITUTIONAL SELF-INTEREST AGAINST AMERICA'S CAPITAL NEEDS. AND, THAT MEANS RECOGNIZING THAT A RISKY VENTURE CAN FAIL WITHOUT A FEDERAL SECURITIES VIOLATION NECESSARILY OCCURRING AND WITHOUT A LOSS IN INVESTOR CONFIDENCE AS TO THE FAIRNESS OF THE MARKETPLACE. IT MAY EVEN MEAN JEOPARDIZING INVESTOR PROTECTION FOR THE SAKE OF THE MORE GENERAL PUBLIC INTEREST AND WELFARE.

YOU MAY BE WONDERING WHETHER, IN LIGHT OF THE QUESTIONS I HAVE RAISED TODAY, I BELIEVE THAT GOVERNMENT REGULATION CAN WORK. THE ANSWER IS THAT I HOPE SO, ALTHOUGH I AM NOT CERTAIN. BUT I AM CERTAIN, THAT OUR PRESENT SCHEME OF FEDERAL REGULATION OF BUSINESS IS OVERGROWN AND OUTMODED, AND THAT IT WILL WORK IN THE FUTURE ONLY IF REGULATORS ARE RESPONSIVE TO THE DEMANDS OF CHANGING TIMES, AND ARE WILLING TO ASK HARD QUESTIONS AND TAKE STRONG STANDS IN RESOLVING DIFFICULT PROBLEMS. WE MUST INSIST THAT GOVERNMENT INTERVENTION IN THE ECONOMY IN FACT IMPROVES THE GENERAL WELFARE RATHER THAN BENEFIT SPECIAL INTEREST GROUPS.

IN 1933, JUSTICE FELIX FRANKFURTER, THEN A NOTED PROFESSOR OF ADMINISTRATIVE LAW, VISUALIZED WHAT IS NECESSARY FOR EFFECTIVE REGULATION UNDER THE THEN NEWLY ENACTED FEDERAL SECURITIES ACT. HE WROTE --

"THE HEART OF REGULATION IS EFFECTIVE ADMINISTRATION, THAT DEMANDS ADEQUATE POWERS AND AMPLE APPROPRIATIONS ENTRUSTED TO ADMINISTRATORS OF COURAGE, IMAGINATION, RESOURCEFULNESS, UNDERSTANDING AND PUBLIC ZEAL." ^{10/}

FORTY FIVE YEARS LATER, I UNSKEPTICALLY ENDORSE FRANKFURTER'S ANALYSIS AS THE CONTINUING IDEAL FOR THE REGULATORY AGENCY.

^{10/} FRANKFURTER, "THE FEDERAL SECURITIES ACT: II", FORTUNE (AUGUST, 1933) 53, 108.