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". . . [AND] FOR THE PRÓTECTION OF INVESTORS"

Edward H. Fleischman
Commissioner
Securities and Exchange Commission
Washington, D.C. 20549

For the more than a quarter century in which I practiced law in the field common to members of this College, I regarded financial regulators, including the S.E.C., as distant if potent authorities, makers of policy and promulgators of rules (to me, seeming more often impedant than constructive) whose interpretation and application was the stuff of much of my professional life, but rarely threatening or immanent to the conduct of ordinary affairs. Perhaps it is additional understanding produced by six years' service as an S.E.C. Commissioner, or perhaps it is a metamorphosis in the regulatory attitude of the S.E.C. itself that merely coincided with some part of these six years, but I am now much more suspicious of regulatory practices, much more skeptical of regulatory intentions, much more concerned about regulatory intrusions, than I used to be.

Analysis of the justice of my suspicions, my skepticism, and my concern requires that I assay the actuality of the S.E.C.'s regulatory agenda against what my experience in both private practice and government service has led me to perceive as the agenda best designed to achieve the public purposes to which financial regulation is directed, and requires that I do so within several discrete (although of course interrelated) contexts that are both basic and common to the proper discharge of regulatory responsibility across the spectrum of financial regulatory agencies. I would choose, for this purpose, the following:

- the tri-functional character -- quasi-executive, quasi-legislative, quasi-judicial -- of financial regulatory agencies,
- the independence of financial regulatory agencies,
- the jurisdictional thrust of financial regulatory agencies,
- the administrative perspective of financial regulatory agencies,
- the encouragement of regulatee law compliance by financial regulatory agencies,
- the deference attributable under Chevron to financial regulatory agencies, and, finally,
- the standards justifying actions of financial regulatory agencies.

It is by reference to those seven contexts that I would cast both my criticisms of, and my aspirations for, the Commission on which

I serve -- and to which, necessarily my reflections must be principally limited. Within "the public interest" which is the overarching objective of all regulation, I would focus particularly on the goal especially allocated to the S.E.C.: "the protection of investors".

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First, tri-functional authority. It is very difficult to sever the performance of quasi-executive functions (that is: enforcement) from the performance of quasi-legislative functions (that is: rulemaking) from the performance of quasi-judicial functions (that is: appellate review) in any of the federal financial regulatory agencies, and certainly in the S.E.C. General policymaking by means of rules blends directly into general policymaking by means of consent orders in enforcement actions. Law enforcement by indictment (that is: authorization to prosecute) blends directly into law enforcement by appellate review of decisions on that same indictment. Case decisionmaking on appeal blends directly into case decisionmaking in statutory and rule interpretations. And there is, within the S.E.C., little beyond the minimum requisite procedural acknowledgment of the overlap or of the difference in those responsibilities. That means that a lawyer's qualms about the differences between rulemaking and proceeding by order, a Commissioner's doubts about the legitimacy of building law by consent on the basis of staff positions and of amicus briefs and even of prior consent orders, a citizen's worries about the loss of the appearance of fairness in the S.E.C.'s quasi-adjudicatory decisions, are denied legitimacy by the S.E.C. itself. And it means that the three separate functions are frequently exercised together in pursuit of the same result-oriented ends.

Six years as a Commissioner have branded upon me a deep conviction that there should be a clear difference in the performance of those distinct functions and in the attitude toward their exercise. Because the turnover rate is high, it has been reasonably rare for any one Commissioner to act in different capacities with respect to the same matter, but the frequency of performance of multiple functions in the same matter is increasing* and is accentuating an institutional problem of important dimension. When I am acting with my badge on as "cop", when what is before me is an investigation or accusation or

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*/ The new Remedies Act has added authority for the S.E.C. to bring cease-and-desist proceedings, administratively, for violations that would previously have been subject to prosecution only in federal courts, and the S.E.C. has organized a special Task Force to recommend means of speeding the process (and of addressing other concerns) in trial and appellate review of all its administrative proceedings.

indictment, I must have some capability to stretch -- to be responsible but aggressive -- in my determinations on questions of law; but when the same matter comes back to me, perhaps three years later, and I am acting with my robes on as "judge", when what is before me is appellate quasi-judicial review, it should be with a quite different pair of glasses, unshadowed by the positions I took three years earlier, that I view those same questions. When I am debating the issues as rulemaker, when what is befcre me is the general permission or prohibition of conduct by all persons similarly situated, I must have wide latitude to steer the debate in pursuit of appropriate policy; but when interpretation of existing rules is required in application to specific conduct, when what is before me is appellate quasi-judicial review, it should be with rigorous regularity, insulated from maneuvering in pursuit of any policy but the vindication of the law, that I discharge my responsibility. Of all of the functions that are accorded to the S.E.C., it is when the Commissioners wear the appellate judges' robes that they should be the most regular, that they should be prescribing for themselves the disciplines that are the tightest, that they should be most loathe to interfere with expected process lest the results on the law partake of that interference, that they should be most strongly striving for judicious interpretations and most strongly resistant to result-oriented ends. That regularity would afford far greater protection to all market participants, including investors, than any single decision or group of decisions driven even by the best of extra-judicial motives.

Second, independence. The key concept of the past several years -- and appropriately so, it seems to me -- in the private-sector governance arena has been accountability. By contrast, the traditional definition of independence for financial regulatory agencies translates, if you think about it, to non-accountability and to all the dangers that non-accountability implies. There is, officially at the S.E.C., an abnegation of responsibility to the White House, to the executive departments and to the other independent agencies, in the spheres of policy making, policy implementation and general regulatory approach. There is always, of course, the opportunity for judicial review of S.E.C. actions, but, reflecting a congeries of judicial pressures and motivations that I'll discuss in a different context, judicial review can be kept extremely limited. What accountability does exist is engendered by interstitial oversight by Congressional committees in hearings that are all too often utilized, by both overseers and the respondent, to play to the media. Sometimes oversight seems not nearly as important, to either overseers or to the respondent, as ensuring that no other Congressional committee, and certainly no executive branch official, is able to assert a coordinate or even a subordinate claim to influence agency policy. By responding with alacrity to issues that elicit current (if transient) Congressional interest, and by stepping nimbly around the known minefields of Congressional antipathies, therefore, the S.E.C. has achieved

that ultimate desideratum of all institutions, governmental and otherwise: effective absence of accountability to anyone but itself.

Insulation from the influence of either the executive or the legislative branch obstructs the proper performance of the S.E.C.'s regulatory function. Think, if you will, of what you, as citizens, expect of a financial regulator in Washington. Pennsylvania Avenue should be a two-way street leading to the S.E.C. both from Capitol Hill and from the White House. The S.E.C. should be seeking input from the White House, the Treasury, other regulatory agencies, and the Congress, and should be eager for coordination of financial regulatory policy. Yet, twice within the time I've been on the Commission, at times when close coordination of regulatory policy seemed an imperative, the S.E.C. has refused to agree on joint market-regulation approaches with other federal financial policymakers. How can that be? Policy coordination by the S.E.C. with other agencies carries no necessary implication of impairment of the professionalism with which the S.E.C. performs its regulatory function. Senator Riegle recently chided the S.E.C.'s Chairman for the mere expression of a willingness to furnish advance copies of testimony to Executive Branch officials -- which the Senator seemed to have interpreted as pre-clearance of testimony with the White House. Much shy of pre-clearance of testimony, the coordination of financial regulatory policy -- and the accountability of the S.E.C. and allied agencies to the public through our only nationally-elected official, which is inherent in inter-agency coordination -- would afford a clear service to the financial markets and to all their participants, particularly to investors. The S.E.C. should be forward in seeking that accountability.

Third, jurisdictional thrust (perhaps less neutrally characterized as jurisdictional imperialism). Some of you have heard me say that the first commandment to all the inside-the-Beltway agencies is, "Thou shalt expand thy jurisdiction with all thy heart, with all thy soul, and with all thy might." Certainly that is comprehensible (if to me reprehensible), since, when acted upon by all agencies, its adoption becomes a matter of self-defense to each. Not only do other agencies' failures enlarge the possibility of greater authority for the S.E.C., but others' successes are likely to impinge upon the S.E.C.'s own sphere. I speak not only of the S.E.C./C.F.T.C. conflict that was so much in the headlines just a year ago; I speak of public opposition to the Treasury's assertion of a formal voice in rulemaking affecting the markets for trading government securities; and I speak simply of non-consultation with other financial regulators whose activities parallel, abut, or impinge on the activities of the S.E.C. I cannot tell you how silly and self-defeating it has seemed to me, from my very first days in Washington, in addressing an issue that involved another federal financial regulator, to phone that agency to say, "This issue

affects your office. Has anybody in your office looked at this proposed rulemaking?", and to receive the response, "What rulemaking? We were never told about it." Neither the S.E.C. nor any other federal financial regulatory agency should proceed in that way.

When I use the word "federal" in this context, I use it deliberately to invoke the sense of "federalism" as well. The S.E.C. has been given peculiar authority to regulate specified conduct (but not the internal affairs) of entities that exist by virtue of state corporate and partnership laws. That's precisely where federalism turns. Yet virtually every time that an issue implicating the line between internal affairs and federally-regulated conduct arises, the S.E.C. finds some way to conclude that the laws we administer or the rules we have promulgated or the policies we espouse preempt whatever has been done in Albany or Harrisburg or Springfield or Sacramento or elsewhere. Why? That doesn't have to be so. Apart from the role that aggressive pursuit of expanded authority plays in the building of reputations in Washington, respect for the legitimacy of state spheres of influence would seem to elicit coordination and reconciliation of federal policy wherever possible.

It is not that the S.E.C. lacks for disclosure tasks to complete or for market regulation challenges to meet or for investment company oversight issues to review and resolve. The S.E.C. does have more than enough to do in the discharge of its mandated responsibilities, and, first and foremost, it <u>should be</u> exercising its very best competence in the areas that have been committed to its charge. We need not be seeking to expand that charge into areas of fellow regulators' expertise, nor need we be seeking to expand the sphere of our authority by preempting state law at any pretext. Rather, the S.E.C. <u>should be</u> requesting the advice and assistance of its fellows at other financial regulatory agencies who are expert in parallel or overlapping areas, and proffering its own advice and assistance where the S.E.C. has the expertise, and it <u>should be</u> utilizing the prophylaxis of disclosure to coordinate federal securities law with state internal-entity law wherever they are reconcilable. And, to carry that thought just one step further, the S.E.C. <u>should even be</u> bold enough to acknowledge that neither Title 15 of the United States Code nor Title 17 of the Code of Federal Regulations supervenes the First Amendment to the Constitution of the United States. Investor protection reaps the greatest benefit from the regulatory competence that the S.E.C. brings to what it does best, and from the self-discipline by which the S.E.C. accepts and promotes the vitality of allied and equally-competent sources of market-related law.

<u>Fourth, administrative perspective</u>. Five years ago I spoke to this College of the inertia ("a matter in motion remains in motion...") that builds up in staff positions and in staff recommendations on their way to the Commission table. Five years

ago, I didn't have the understanding to see through to the managerialization of the S.E.C., by which I mean the increasing concentration of administrative authority in the office of the S.E.C.'s Chairman under two extraordinarily effective private-sector managers, Harold Williams and John Shad. Five years ago, the Commission included four persons, in addition to the Chairman, with strong opinions of their own, and three persons, in addition to the Chairman, with insight into or experience in the effect of regulatory policy in the regulated arena. What has changed in these five years is that experience in government has been substituted for understanding of regulatory impact on the regulated arena, and has been added to a centripetal Chairmanship. The staff has been harnessed to that experience and to the perspective it brings, with the result that, since every staff recommendation now requires the Chairman's review and approval before it ever emerges as a staff recommendation at all, the present-day inertia combines pressure from both staff and Chairman into regulatory motion that only the likelihood of public embarrassment can deflect.

Further, a benefit once believed inherent in the commission form of federal regulatory agency was the interaction of multiple viewpoints, reflecting a variety of experience relating to the regulated arena, in the resolution of regulatory problems and in the promulgation and enforcement of regulatory norms. The commission form also lent itself to the introduction and acceptance, into the process of regulatory policymaking, of stimuli from non-legal and non-governmental sources, and thereby promoted a recognition of the advantages of synthesis of constructive features from conflicting views. In these last years, however, the S.E.C. has become single-sourced and indistinguishably mono-voiced, walling out both internal sources of policy disagreement and external sources of competitive policy conclusions. And such recent in-the-market experience as exists (there is none any longer at the Commission level, but some does exist within the senior staff, in a Division director or an Office chief) is force-filtered through a government-regulation-oriented policymaking funnel. In their approach to as well as their exit from that funnel, S.E.C. regulatory decisions are protected against exposure to the expertise of parallel non-legal professionals and of autonomous extra-governmental institutions.

Not only is there no need for that kind of hear-no-other, see-no-other, admit-no-other perspective at the S.E.C., but in fact, openness to and absorption of differing approaches and differing disciplines would provide stimulus, strength and support to the S.E.C.'s regulatory policymaking function and its investor protection goals. For example, in the performance of its rulemaking function, the S.E.C. should resist being so self-protective of S.E.C.-initiated standards, so xenophobic in the sense of distrusting the likely propriety of any market standard whose origin is not American. On the contrary, whenever we agree with other countries on basic investor protections, we should be

reaching out to each of those countries on the basis that their regulatory scheme is fundamentally analogous to ours, that they are striving for the same ends, that they are using the same essential means although not every detail of their structure is the same, and therefore that, if their regulatory standards are acceptable for market participants in their own country, then we should be welcoming their people into our markets just as we would anticipate that our people would be welcome in their markets. That notion of reciprocity did manage to find its way three years ago into one sentence of one S.E.C. release, and it lies embedded in the U.S.-Canadian multijurisdictional disclosure rules, but it should be affirmatively espoused for the advantage it promises to all investors in an ever-narrowing transnational market world. Adapting the words of retiring I.C.I. President David Silver, recently quoted in the financial press: "by ... focusing on core investor protection concerns we can achieve greater success in breaking down existing barriers to cross-border [market participation] -- to the benefit of the world economy and [of] the world's investors."

Similarly, in the performance of its role as overseer of the securities marketplaces, the S.E.C. should be quick to take advantage of the deep well of understanding, possessed by the governors and the officials of those marketplaces, of what actually goes on in the markets. Like all Washington-bound regulators, the S.E.C. is always behind in its learning curve, always struggling to keep pace with developments in the markets, and it should be willing to afford some deference in self-regulatory rulemaking to the hands-on knowledge of the market governors, particularly when they provide (or undertake to provide) empirical data to buttress their professional convictions.

Empirical data and professional economic studies are recognized today, worldwide, for the foundation they provide to the structure and regulation of markets. It took the S.E.C. nearly a decade to build up a critical mass of Ph.D.s in Economics who brought to the Commission table an economic analysis of market issues, and we have now dissipated most of that capability. Can you conceive that in 1990-1991 the federal regulator of the capital markets of the United States has slashed the professional muscle of its Office of Economic Analysis? My former colleague Joe Grundfest was recently quoted as saying: "Imagine if the FDA had no chemists [or] biologists and was staffed totally with lawyers." The S.E.C. should be applying rigorous quantitative analysis across the panoply of policymaking issues with which it is faced, not merely in the determination, in particular cases, of the materiality of inside information based on whether post-disclosure market investment was (in economic parlance) statistically significant.

In its consideration of self-regulatory pilot rules, to which a professional economics approach was introduced step-by-step culminating in the acceptance of the New York Stock

Exchange's pilot Rule 80A in July 1990, the S.E.C. should be holding fast to the requirements for analysis of pre-specified market indicia, consideration of alternative means, and fulfillment of pre-prescribed minimum criteria, rather than equivocating so as to allow after-the-fact rationalization of the pilot's success or failure. That professional protocol approach should be institutionalized wherever it is applicable, so that it is no longer dependent on any Commissioner's particular interest but is automatically woven into the S.E.C.'s processes of substantive consideration (in just the way that regulatory impact on small business concerns was originally supposed to be considered to implement the Regulatory Flexibility Act.)

My use of the examples of international reciprocity, marketplace self-governance, and professional economics standards highlights the S.E.C.'s need for variegated private-sector and professional perspectives at the staff level and particularly at the Commission table. The S.E.C. should be searching in all the market-oriented professions, and in academe, for prospective regulators who will bring complementary experience and insight to the performance of its regulatory responsibilities.* The S.E.C. makes market-affecting determinations daily, acting as if we know all there is to know about the markets and the market participants. The protection of those markets and those market participants, including investors, should be driving the S.E.C. to complement the perspective of those whose background is in the corridors of government with the perspective of those whose experience is in the hurly-burly of the financial markets.

Differing perspectives imply occasional disagreements, challenging (rather than affronting) the majority view; constant unanimity suggests intolerance of differences. I treasure the memory of the closed Commission meeting at which John Shad said

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*/ The last time there was an accountant sitting as a Commissioner of the regulatory agency that is vested with ultimate authority over much of the corpus of accounting principles and auditing standards was more than 20 years ago. There's never been an internal auditor on the S.E.C.; there's never been a broker/dealer administrative or compliance official. We did have an economist for several years until 1989, and a bi-professional in the dismal science for a year and a half thereafter. We had an inside corporate lawyer for only one year and a quarter during the last decade (and I do miss Phil Lochner). Other than John Shad, I cannot tell you when we had the last real investment banker on the Commission. And there's never been a Commissioner, so far as any of us knows, from the institutional investor community -- either from the private investment area represented by this College or from the public investment area that owns a substantial fraction of America's publicly-traded securities.

to my then colleagues, "You have all considered this matter at a prior stage, or perhaps two or three. Ed is the new boy on the block; he has not been involved before. I want you to try to dissociate yourselves from the fact that you've reached an earlier decision, and let Ed try to persuade you to a different conclusion." That's all anyone can ask at the Commission table, but it's extraordinarily important. The S.E.C. should always be seeking the stimulation of contrariety, the openness to modification of views that comes with respect for others' convictions and others' experience.

Part and parcel of that openness to modification of views is the capacity for self-criticism and re-direction. The S.E.C. should be ever-alert for indications that regulatory decisions would be inappropriate if pursued, or were incorrect when made, or have become counterproductive with the passage of time, and should be first (not last) to admit regulatory mistakes, whether past or pending. To believe one's self to be above criticism is to betray the Washingtonian's ignorance of what every businessman and trader in every commercial or financial marketplace learns early: no market participant (and no market regulator) is right nearly as often as he or she believes. From just such continuing institutional willingness, especially by the S.E.C., to reevaluate and reconsider market-regulatory decisions, in light of internal as well as external criticism, comes a true source of protection for investors.

Fifth, encouragement of regulatee law compliance. The use of particular cases for programmatic expansion has been a source of imaginative strength for the S.E.C. since Judge Sporkin's day, and the temptation to use cases for that purpose is virtually irresistible. The very authorization of an order for enforcement proceedings or of a complaint to a federal district judge, as yet in either instance nothing but allegations, can set forth the Commission's view of what constitutes the law and what constitutes wrongdoing under the law, and can thereafter serve as the basis for allegations that others recklessly ignored (and therefore violated) what the S.E.C. had already stated was the law. While responsible performance of the S.E.C.'s rulemaking function would often call for advance prescription or proscription of regulatee conduct, you must remember that it is only by prosecutory enforcement, not by rulemaking or by any other compliance-evoking mechanism, that the S.E.C. and those credited with its successes become eligible for the gold stars of media and public approval. Anything else is simply too quiet and too complicated; for the headlines and the hearings, only prosecutory enforcement will do. Should the S.E.C. seek to define "insider trading", or should it bring enforcement prosecutions that assume a nonexistent definition? Should the S.E.C. seek to clarify what is "material" by interpretation or by rulemaking, or should it bring enforcement prosecutions that reflect the clarity of materiality viewed in hindsight so that

the threshold of mandated disclosure is ever uncertain? Should the S.E.C. clothe "recklessness" (substituting for actual knowledge) in anything like its ordinary laymen's meaning, or should it bring enforcement prosecutions still further attenuating the requirement of cognition that once was a prerequisite to most law violations? In each instance, quite clearly, the answer is the latter.

Does the S.E.C., in fact, bring enforcement actions where materiality or knowledge is unclear? No; or, rather, extremely rarely. But we will fight all the way to the petition for certiorari rather than concede either of those issues. And then we will fight again to dissuade the courts from awarding the occasional winner any reimbursement on his or her Equal Access to Justice claim. Of course, most of the really difficult cases get settled on other grounds, lest some unsympathetic court rein in the S.E.C.'s prosecutorial sweep, so the cases with the harshest facts are brought to indignant judges, evoking the broadest generalizations and leaving behind the most-difficult-to-deal-with legal legacies. The cost of the pursuit of this prosecutorial policy by the S.E.C. is, for example, that, while no member of this College has ever seen an enforcement action on integration grounds brought against an institutional investor, all institutional lawyers turn somersaults in institutional transactions to avoid the consequences of S.E.C. interpretations arising out of boiler-room offerings -- and the S.E.C. refuses to clarify the distinction between the boiler-room and the institutional transactions. To repeat, public prosecutory enforcement is not only the handiest, it is also the most reputation-building tool that any ambitious government official has in the tool chest. No other method rivals prosecution for broad-brush lawmaking, for deterrence of others' conduct (both lawful and unlawful conduct), or for notoriety -- and those are the paving stones to media and public attention in the peculiar theater that we call Washington.

Think to yourself what you would choose as the optimal regulatory course if you were faced with the circumstance in which a company -- most likely a public commercial or industrial enterprise but perhaps a regulated entity -- found a securities law compliance problem, perhaps stumbled on the problem but found it, fixed it and then brought it to the attention of the S.E.C. As a policy matter, is the best way to proceed by initiating an enforcement action, humbling that company, levying on its present securityholders and employees to the benefit of a group of prior holders, and thereby deterring others from risking the same violation? Or is a still better way to proceed by telling that company, "Yes, whether accidentally or because they were properly designed, your procedures found the problem; you resolved it yourself with your own audit committee, your own internal or external auditors and your own counsel; and we will give you credit for that; now go out and pass the word that companies which design procedures, find their own securities law compliance problems, fix those problems and bring them to us for review,

will not undergo the charge, shame and cost of a public enforcement prosecution."? That latter approach receives no headlines or public gold stars. In my view, however, it promotes enforcement and compliance with the law in a far more contagious way, and thereby far more effectively promotes investor protection. The S.E.C. should be utilizing that approach whenever it is applicable.

It is Treasury Secretary Brady who, in a speech just last month, called for "swift and fair justice from balanced and consistent regulators." The Secretary pointed up the choice, and the temptation, in enforcement alternatives quite clearly: "In the desire to seek out criminals and build our reputation as tough enforcers, let us not forget that there are many honorable people in our financial institutions who are as appalled as we are at recent events." And: "We in the regulatory community will have the laboring oar in creating new regulations [and, I would add, new enforcement policies]. If they are sensible, they will improve our chances to avoid this kind of fraud in the future. But ... if the system we create is too onerous, the money and the markets will work around it or not work at all." The Secretary's theme should be constantly considered in the selection of enforcement alternatives by the S.E.C. Not the media's and the public's acclaim for a broadsword-wielding, muscle-flexing regulator, but rather the effective spreading of the contagion of law compliance, creates the market system with the most genuine protection for investors.

Sixth, deference attributable under Chevron (perhaps more accurately characterized as deference claimed under Chevron). The Supreme Court has mandated that the federal courts defer to the regulatory agencies in the areas of expertise committed to their charge, perhaps not as to fundamental jurisdiction or federal preemption but in the interpretation of statutory measures and in the determination of regulatory means. As a result, the S.E.C. alone will be the arbiter of the scope of much of the new authority granted to it in the new Remedies Act, and I dare say that not one of the institutions represented by the members of this College will be unaffected by the S.E.C.'s determinations in that regard. The mandated withdrawal of the federal courts from their accustomed substantive-review role has been explained as a device for managing the federal appellate docket, as a recognition of lack of judicial competence in complex regulatory spheres, and as a substitute for structural change in the operation of the Supreme Court itself. But, in my view, that withdrawal, and the deference mandated by Chevron, is a terrible error. Absent a rare Justice Powell, the S.E.C. need fear no judicial rebuke (the prominent cases you may think of to the contrary are criminal cases, treated differently by the courts), and the S.E.C. asserts its Chevron shield against rebuke every time.

A story is told about Judge Healy, who was an S.E.C. Commissioner from 1934 to 1946.* When an S.E.C. staff attorney once came to the Commission table and indicated he would argue to the Court of Appeals that the S.E.C. decision at issue should be upheld on the basis of the substantial evidence rule, Judge Healy leaned across the table and said, "I want you to go to that Circuit Court and say, 'Your Honors, we may be entitled to an additional defense as a federal agency, but we do not advance it before you. Our defense rests on what we did, on our reasons for doing it, and on our belief that we acted properly. If you think we acted inappropriately, please tell us so, and we shall act as you think proper.'" That is the tradition of the S.E.C. It is a tradition that the S.E.C. has in recent years abandoned, and it is a tradition that the S.E.C. should revive with pride. Rather than asserting its claim of Chevron deference, the S.E.C. should be approaching the federal appeals courts with Judge Healy's admonition, "'If you think we acted inappropriately, please tell us so.'" The protection of questionable actions by the S.E.C. may thereby suffer, but the protection of investors will be enhanced.

Last, the discretionary standards justifying regulatory action (in the S.E.C.'s case usually epitomized as "the public interest or the protection of investors"). The breadth of those legislative standards has afforded a cloak to cover a wide variety of pre-decided, result-oriented determinations. "Pre-decided" need not be an accusation; as lawyers, we are accustomed to the notion that today's decision flows from decisions made yesterday and yesteryear. But "result-oriented" is intended to be pejorative. Lawyers are educated to understand the balancing process in decisionmaking, the necessity to accommodate individual determinations made in particular contexts even though they strain or burst general programmatic intentions. When, however, the S.E.C.'s current programmatic intentions conflict with the consistent application of principles of market regulation, when they conflict with doctrines of regulatory structure, when they conflict with tenets of federalism, or even when they conflict with canons of professional responsibility, unhappily it is those principles, those doctrines, those tenets, those canons, that are set aside.

Let me give some recent examples. Transparency in the markets, to which the S.E.C. is supposedly committed specifically for investor protection, was set aside not only in off-hours trading but also when it came time to decide whether the smaller public companies should be left on the trading screen or thrown to what is now called, anticipatively, the Bulletin Board. Functional regulation, to which the S.E.C. has supposedly been devoted since John Shad's time and which was a principal

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*/ I am indebted to Milt Freeman for telling me this story.

recommendation of the Bush Task Force Report on Regulation of Financial Services, was set aside in our battle with the C.F.T.C. As to federalism: in a situation in which the laws of a state allowed for corporate charter provisions substituting arbitration for litigation of stockholder complaints, and in which a domiciled registrant included those rights in its charter, the S.E.C. refused to allow the registration statement to go effective because the S.E.C. simply would not honor the state's decision to allow a mandatory arbitration provision to be written into a publicly-traded corporation's charter. As to professionals in the fields of law and accounting: the S.E.C. has pressed for whistleblowing as an enforcement tool for as long as most of us can remember (most recently just a few years ago in the Oak Industries consent orders),* regardless of the disciplinary rules generally applicable to professional practitioners, because acceptance of the whistleblowing obligation by professionals would yield enormous programmatic leverage to the S.E.C. Each of these can be justified within the non-directive, nowhere-anchored discretion construed by the S.E.C. into the legislative standards over the decades -- and particularly in recent years. Only in abstruse areas like the Public Utility Holding Company Act are the directions of Congress sufficiently detailed to rein in the freedom to identify the public interest and the protection of investors with whatever happens to be the S.E.C.'s current program.

I do not doubt that the S.E.C. -- both staff and Commission -- is composed of spirited, hard-working, concerned campaigners in the trench warfare against market abuses, who, having heard the battle slogans repeatedly recited without any critical examination of the content or implications of those slogans, do carry the conviction that they are combatants for what is good and true. But I put to you that, as is likely to happen in any such situation, an element of self-righteousness and a habit of confusing battle tactics with war aims have affected the struggle for the good and the true. If, for example, the need for disclosure or the need for regulation or the elements of a violation are so clear to the S.E.C., how can there be any doubt or disagreement that rulemaking or prosecutory enforcement to fill that need or to establish that violation is in the public interest? Or if there is a need, equally clear to the S.E.C., for enforcement or for regulation just a bit beyond the S.E.C.'s statutory reach, how can there be any doubt or disagreement that stretching somewhat to authorize that enforcement or to adopt that regulation is for the protection of investors? And what seditious motives have to be attributed to the treason of doubt

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*/ I must confess that, although I was a Commissioner at the time, I failed to notice the whistleblowing obligation buried in those orders until it was flagged in a lawyers' weekly journal.

or disagreement? Well, I have to tell you that, even in the face of charges of treason, I can doubt, I can sometimes disagree, and I do.

Each time the S.E.C. requests new authority from Congress -- and we do seem to make those requests with great frequency nowadays -- the S.E.C. should be asking Congress to include the particular purposes for which that new authority is to be enacted. But until then, since the very breadth of the discretion in the existing legislative standards has been utilized to drain almost all real meaning out of those standards, the S.E.C. should be articulating content for the standards' generality to address those goals of market regulation that are fundamental and ever-present: the facilitation of capital-raising for enterprise and for government; the efficiency and honesty of secondary market price-discovery and trading mechanisms; the distribution of relevant information for impounding into current valuation; the participation, directly and through intermediation, of a broad portion of the general public, so as to maintain legitimacy in the nation's politico-philosophic framework; the elimination of systemic risk; the promotion of self-regulatory insistence on just and equitable principles of trade; and, by no means least, the minimization of governmental intrusion. Put another way, the S.E.C. should be responding to the market challenges of this and later decades not by ad hoc justification of S.E.C.-aggrandizing programs but by reference to a set of consistent and comprehensive principles vindicating the core concerns expressed as "the public interest or the protection of investors."

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It's not that I think that my solutions, my "should be"s, are the only solutions. It is, rather, the lack of concern, in fact the satisfaction, of the Breeden Commission with the increasing extent of discretion claimed by the S.E.C., its increasing resistance to accountability for that exercise, and its increasing justification of that resistance by reference to its own self-attributed beneficence, that leaves me -- and you, and all the investing public -- with no "should be" alternatives to the status quo other than these. In my deeply-considered view, the only effective barrier -- ultimately the only meaningful constraint -- on the Commission is the continual insistence, from inside as importantly as from outside the Commission, that the public be the master and not the servant of the regulatory agency created in its interest and for its protection. Only a self-examining, self-restraining, self-annealing S.E.C., subjected to the fire of its own constant self-probing, concerned always (like each of us) about the putative correctness of its own actions, and the putative propriety of its own policies, can provide the quality of market regulation that we as public and as investors demand from the S.E.C. -- and are entitled to receive.

Chairman Breeden was recently quoted in the newspapers as saying, at a Congressional hearing addressed to the current, headline-making revelations about malpractices affecting Treasury security auctions:

> Enormous power over a particular market segment can lead to arrogance, can lead to conclusions that it's within a firm's power to do things that would be unlawful and that might lead to temptations to do so.

I put it to you, sorrowfully and apprehensively, that that statement can legitimately be modulated to read:

> Enormous power over the markets in general can lead to arrogance, can lead to conclusions that it's within a regulatory agency's power to do things that are damaging to the markets and the underlying purposes of the law if not unlawful, and that do lead to temptations to do so.

But I put it to you as well that the statement so expressed need not be so, now or at any other time. The statement would <u>best</u> be modulated -- the S.E.C. <u>should</u> <u>always</u> <u>be</u> seen to act so that the statement justifies being modulated -- to read:

> Enormous discretion over the markets, judiciously and consistently exercised, can lead to pride, can lead to conclusions that it's within a regulatory agency's power to put investor protection ahead of agency self-protection, to put the public interest ahead of institutional self-interest, and <u>that</u> could lead to the realization of the full potential of what was acknowledgedly for so many years the best of the federal regulatory agencies, acting in a manner truly appropriate in the public interest and for the thoughtful, long-term protection of investors.