REMARKS OF
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

BEFORE THE
NASAA/SEC ANNUAL 19(c) CONFERENCE

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***The views expressed herein are those of Commissioner Schapiro and do not necessarily represent those of the Commission, other Commissioners or the staff.**

U.S. Securities and Exchange Commission
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Good morning. I'd like to preface my remarks by thanking Fowler West and Karen O'Brien for inviting me to speak today. I've known Fowler for many years, and I have the highest regard for his professional talents and personal integrity. I know that he will serve NASAA very well in the coming years.

It is a distinct pleasure, and honor, for me to address the members of this conference. I would like to urge you -- and my colleagues on the Commission and on the staff of the SEC -- to approach this year with a renewed commitment to work together for the benefit of U.S. markets and investors. The differences of the past can and should be put behind us all, for we have much to accomplish. I recognize that the SEC is not the only cop on the beat; and we do not have a monopoly on good ideas about how to increase capital formation, or protect investors, or maintain the integrity of our markets. This is as much the business of the states as it is the concern of the SEC.

Because of the commonality of our mandates, it is imperative that the SEC and NASAA work in concert on a large number of projects. There are so many issues that need to be tackled, and that

can be brought to closure, when we marshall our resources for the common good of investors. One need only look to the multijurisdictional accord negotiated by NASAA, the SEC and Canada to see the positive and far-reaching results our joint efforts can have. In the enforcement area, numerous states helped the Commission bring some of its most important cases this year. To give only one recent example, our New York Regional Office received assistance -- and is continuing to do so -- from state regulators in New York, Maine, Massachusetts and Virginia, in bringing a very large sales practice abuse case against First Investors Corporation.

I know that in the recent past, there has been some tension between the goals of the SEC, and our timetable for achieving those goals, and the agenda and concerns of individual state regulators. Certainly, the debate concerning the "testing the waters" provision of the small business initiatives enacted by the SEC last year, should not go down in history as the hallmark of the SEC/state relationship. I believe that experience was an unfortunate and ill-advised deviation from the norm. Having said this, however, I also have to say that the Commission's rule amendments to Regulation A reflect sound regulatory policy and should serve as a model for state initiatives in this area. As you know, what's important at the end of the day is the

result you achieve; I just happen to think that in this instance a superior result may have been possible if the SEC had taken the time to fully consider the views of state securities regulators. Let me assure you that the SEC is committed to working as closely as possible with NASAA on issues of mutual concern. The relationship between NASAA and the SEC should be one of the Commission's strengths, not its Achilles' heel.

Today's agenda is a very full one, so I am going to limit my remarks to a short list of topics that will probably be debated in the discussion groups.

In the corporate finance area, the issue of what more can be done at the federal and state levels to facilitate the flow of capital to small businesses is likely to retain its high position on the Commission's list of priorities. The rule amendments enacted this past summer -- collectively referred to as the "Small Business Initiatives" -- have had a stunningly positive impact.[1] The volume of Regulation A offerings almost quadrupled to $89 million, compared

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[1] See Securities Act Release No. 6949 (July 30, 1992).

with $22.6 million before the amendments.[2] There have been seventy-four offerings, totaling $641.2 million, registered by small businesses on the new form SB-2. And, for the four-month period ending with calendar year 1992, more than 578 offerings, valued at $183.1 million, have been made pursuant to the most recent amendment to Rule 504 of Regulation D.

The important thing for NASAA and the SEC to pursue now is how to streamline the state registration and reporting processes, so that we achieve a simplified, uniform system at both the state and federal levels. In preparing my remarks for this morning, I read the exposure draft of a model state form for solicitations of interest prior to the filing of a registration statement. This form differs somewhat from the Commission's "testing the waters" rule; for example, under the proposed state form, an offerer must file with the proper state authority a Solicitation of Interest Form ten business days prior to the initial solicitation. As you know, the federal rule permits solicitation immediately upon filing with the Commission. The proposed state form also mandates a seven day "cooling-off" period, and requires more detailed disclosure concerning the offerer's officers and

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[2] Comparing filings made under Regulation A during the periods August 13, 1992-February 19, 1993, and August 13, 1991-February 19, 1992.

directors. I do have concerns that a seven day cooling-off period from the delivery of the final offering statement may be a little long -- particularly for companies that have underwriters. Otherwise, these differences from the federal rule are not major, and should not, I believe, result in a much more burdensome registration process for Regulation A filers. Accordingly, I hope that a large number of states will act promptly to take the steps necessary to adopt this model. And, I hope you will evaluate its use over time and give consideration to modifying it in line with the federal requirements if experience indicates that would be appropriate.

In addition to amending Regulation A, the Commission last year also made it possible for certain issuers to raise up to $1 million in a twelve-month period, without having to comply with the federal securities laws. These issuers however remain subject to federal antifraud and civil liability provisions.

I understand that the Commission's decision to exempt these offerings from federal scrutiny was not met with wild enthusiasm by state regulators. This may well be an area where we will have to respectfully "agree to disagree." The SEC's decision reflected our determination that issuers should be able to undertake small offerings

without incurring the substantial expense of compliance with federal disclosure requirements. Further cost savings would be realized of course if the states came to a similar conclusion. While I understand your concerns, I hope we can re-open a dialogue on this issue and perhaps persuade some of you to raise the level of your exempt offerings, even if not to $1 million.

As you know, tomorrow the Commission will vote on further revisions to Regulations A and D.[3] Last summer the Commission proposed to allow small business issuers to transition from non-reporting to reporting status using Regulation A disclosures, with the addition of audited financial statements. As it was proposed, transitional reporting would be permitted for issuers that do not register more than $5 million under the Securities Act in a single fiscal year[4], and filers would not be required to update their MD&A disclosure on a quarterly basis. The Commission also proposed amendments to both the non-financial and the audited financial statement requirements of Regulation D.

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[3] See Securities Act Release No. 6950 (July 30, 1992).

[4] In addition, issuers must not have filed on a standard small business disclosure form (other than the proxy statement disclosure required by Schedule 14A), and must meet the definition of small business issuer.

The public comments the Commission has received on these proposals have generally been favorable, and of course, some commenters would have us go further.[5] My track record for predicting the reaction of my colleagues to any particular set of comments is not very good, so I will not try to predict the outcome of Tuesday's vote. I will tell you however, that I have a strong preference for moving in tandem with the states (through NASAA) on any further small business initiatives, and I would be particularly reluctant to move ahead at this time with revisions to the financial statement requirements in Reg. D, which are so strongly opposed by NASAA.

On the Investment Adviser Act front, there is reason to be optimistic that important legislation will be passed in this session of Congress. The Investment Adviser Regulatory Enhancement and Disclosure Act of 1993 -- which is very similar to a predecessor bill supported by NASAA and the Commission -- was reported out of the Committee on Energy and Commerce on April 20, 1993. As you

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[5] See e.g., letter from American Bar Association, Section of Business Law, to Jonathan G. Katz, Secretary, SEC, dated October 16, 1992; letters from Barry C. Guthary, President, NASAA, to Jonathan G. Katz, SEC, dated September 10 and October 5, 1992.

know, this bill would provide the Commission with critically needed resources to support an enhanced inspection program. In addition to the new fees that would be levied, the bill contains a number of other provisions that provide significant investor protections. These include:

* an express suitability requirement;
* authority for the Commission to require bonding of advisers that have custody of, or exercise discretionary control over, client assets; and
* periodic reporting of fees, expenses and account information.

Finally, and perhaps most relevant to the goals of this conference, the bill would authorize the Commission to participate with the states in a one-stop filing system for investment advisers, similar to the CRD system currently in place for broker-dealers. Advisers will have less paperwork and state and federal regulators will have a superior system for sharing information.

Before leaving the investment management area, I would be remiss if I did not comment on the Commission's recently published proposal to amend rule 482 under the Securities Act, to permit mutual

fund advertisements, in the form of "off-the-page" prospectuses, to include an order form for purchasing shares. Some concern has been expressed about this proposal, by members of NASAA and others, on the ground that investors will be put at risk, and may make bad investment decisions, if they elect to invest on the basis of the information provided in the off-the-page prospectus, rather than as a result of reading the full section 10(a) prospectus.

I am always sympathetic to arguments that raise investor protection concerns, but in this case I believe there have been some misunderstandings about the potential risks associated with this proposal. The amendments in fact may dramatically improve the disclosure available to investors, by providing them with easily accessible and comparable information about the things that are most important to their investment decision, i.e., fees and expenses, historical performance data, investment objectives and policies, risks and redemption procedures, special tax consequences, and policies concerning dividends and distributions. This information can be communicated more clearly and succinctly in one or two pages that investors might actually read, than in the traditional prospectus. In addition, the off-the-page prospectus would carry prospectus liability under the Securities Act for false or misleading statements. An

investor will still receive the section 10(a) prospectus no later than delivery of the security or confirmation of the sale, and of course the investor still has the right to receive the full prospectus first if he or she wishes.

I am very interested in receiving your comments on this proposal. In particular, I would like to hear your views on whether the disclosure requirements of the proposal could be improved.

Now, switching topics, I want to comment briefly on another regulatory relationship, the one between the SEC and the Commodity Futures Trading Commission ("CFTC"). I bring this up because there has been renewed discussion of late about the structure of US financial services regulation. It is only logical at the beginning of a new administration, particularly one that believes that excellence in government is an important and attainable goal, that there should be some examination of whether our regulatory structure is best designed to protect investors, ensure the integrity of the financial system, and facilitate capital formation as well as risk management in a cost effective manner. At the same time, whenever possible, such a system should encourage competition and innovation, which have been the genius of our financial markets.

This debate, which in the past has most often centered on the issue of whether there should be just one regulator for securities, options, futures, and hybrid derivative instruments, need not degenerate into a jurisdictional dispute between the SEC and the CFTC. Indeed, in an increasingly international and institutional marketplace, I believe it is important to re-examine whether our system is equipped going forward to maintain the preeminent role of the US in world markets. Nevertheless, I do not believe that internationalization and institutionalization should become code words for the sacrifice of basic investor protections. Rather, I believe it is important that we balance these objectives so that the US markets maintain their historic role as the fairest, most open markets in the world.

I am more than aware that past forays into this subject have left everyone feeling bruised and battered, wasted enormous resources, created inter-agency tension, and produced no change for the better. The dispute, which has largely been the result of the exclusive jurisdiction provision of the Commodity Exchange Act ("CEA") and the requirement of the CEA that futures trade only on boards of trade, has stifled innovation as new products searched for the appropriate

venue in which to trade and missed market opportunities while the courts wrestled with the metaphysical question of what turns a security into a futures contract. It is hard to overestimate the day-to-day impact of jurisdictional confusion and conflict on the operations of the agencies, the brokerage firms and the exchanges. It does not need to be this way. By granting the CFTC exemptive authority to permit products to trade outside of its regulatory system, Congress has set the stage for a new beginning. Thus, without some of the pressures of the past, we have an especially good opportunity to coolly and rationally examine whether structural change makes sense, including a change that could go beyond the consolidation of the SEC and the CFTC, to include other financial market regulators as well.

What makes this a good time to take a careful look at these issues again? A new administration interested in good government, unrelenting external competitive pressures, a grudging acceptance by an increasing number of "players" that there may be a better way to do it and most importantly, a further blurring of the lines that previously delineated products or institutions or trading strategies. The American Banker reported last week that in the past decade more than seventy banks have launched proprietary mutual funds. <u>The</u>

Wall Street Journal also reported last week that General Electric will ask the SEC for the ability to sell mutual funds to the general public, targeting in particular 401(K) plans. Finance companies, owned by commercial companies, are operating very much like banks, making the same kinds of loans and funding their operations through the issuance of commercial paper, largely purchased by money market funds. Broker-dealers are establishing separately capitalized subsidiaries to engage in a huge volume of customized derivative transactions that have the qualities of options, futures or forwards, but which are not traded on exchanges. Commercial banks are major intermediaries in the over-the-counter ("OTC") derivatives markets, with Citibank, Bankers Trust and JP Morgan involved in interest rate and other derivatives, with a notional amount of two trillion dollars at the end of 1992. The Chicago Board of Trade has proposed exchange-traded SWAPs. The options exchanges are seeking to trade Buy-Write Option Unitary Derivatives or "BOUNDS," but have been stalled by regulatory uncertainty. The list of crossover products and institutions goes on and on, but you get the idea.

The Economic Policy Institute, based here in Washington, recently published a paper suggesting that the "carefully compartmentalized credit and capital marketplace established in the New Deal legislation

60 years ago" has been broken down by the advent of multifunctional financial conglomerates and the emergence of an unregulated or partially regulated parallel banking system. Banks, money market funds, thrifts, mortgage companies, and finance companies do not compete on the ever elusive "level playing field", but instead bear widely disparate costs of regulation, to the ultimate detriment of the role played by US banks in financial intermediation. The Institute paper recommends the establishment of a Financial Industry Licensing Act that would require all financial firms to be licensed and comply with the same regulations and requirements for safety and soundness.

Similarly, Jack Sandner, chairman of the Chicago Mercantile Exchange, in a paper submitted to President Clinton, calls for a restructuring of financial services regulation so that financial products, services and markets delivering similar benefits and risks will be subject to substantially equivalent regulation. Economic competition, rather than jurisdictional barriers or differences in supervision, will determine the winners and losers in the marketplace. Just as the CME was once the upstart, brash newcomer offering products that competed effectively and at lower cost with the traditional securities exchanges, the OTC derivatives market has

become a thorn in the side of the now "establishment" futures exchanges. The CME, as well as the other organized exchanges, are feeling the very same pressure from new and growing markets that they once exerted on the New York Stock Exchange. And, the arguments that the NYSE made about undue leverage in stock index futures, and lower regulatory burdens borne by the CME, are not dissimilar to the arguments we hear from the CME about the swaps market.

Sandner proposes consolidation of the Comptroller of the Currency, the FDIC, CFTC, SEC, SIPC, PBGC and some functions of the Department of Labor and the Federal Reserve Board into a single cabinet department, the Federal Financial Regulatory Service. The eight operating divisions of the new agency would divide key elements of regulation, such as, disclosure and reporting, customer protection, and prudential and systemic risk management, without regard to product, while segregating risk shifting markets from both investment markets and banking and insurance (which are combined). While I would argue against a number of the suggestions for statutory reform, such as recognition of home country accounting standards, my principal concern is that such a large agency, burdened by the problems associated with bank failure and the threat

to pension funds, would not keep pace with the innovation that characterizes the securities and futures markets. One of the strengths of both the CFTC and the SEC is the responsibility of market regulators for prudential, systemic and customer protection issues and their availability and involvement in examinations and enforcement.

Accordingly, while it is an elegant vehicle for discussion of regulatory reform, it is not a road map to it. Anything that would diminish the effective and vigorous enforcement of the law or market oversight, for which the SEC is well known, would not be an acceptable compromise in a regulatory restructuring. Our goals should be to quickly get new products to market and ensure that they can compete on a regulatory level playing field, but not at the expense of investor protection. We must also consider the role and concerns of the states in any reorganization. Whether the new structure proposed by the CME and others accomplishes these goals is certainly worth studying.

I have taken enough of your time and you have a very full agenda ahead of you. I hope that my remarks today have helped to set the stage for the discussions you are about to undertake. As long as

NASAA and the Commission pursue their missions in a spirit of comity and goodwill, I am certain that the outcome will be a positive one for investors.

Thank you.

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