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News Release

COMMISSION INITIATIVES FOR THE 1990s: ENHANCING U.S. COMPETITIVENESS IN THE GLOBAL MARKETPLACE

Remarks of

Richard C. Breeden, Chairman
U.S. Securities and Exchange Commission

Ninth Annual
SEC and Financial Reporting Institute Conference
Los Angeles, California

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I. INTRODUCTION

My focus today will be on the condition of the U.S. capital markets, and a wide range of Commission initiatives designed to enhance the vitality of these markets. Achieving this goal is essential to ensuring the continued economic competitiveness of the United States in the international arena, since a strong domestic securities market is crucial to capital formation, job creation and overall economic growth.

II. CURRENT TRENDS IN THE U.S. EQUITY MARKETS

Throughout this century, the U.S. equity markets have been characterized by a depth, liquidity and fundamental fairness and stability that have attracted investment capital from around the world. Our equity markets performed reasonably well during the 1980s, with an aggregate rate of return of about 400 percent, capped off with a 31.5 percent rate last year. Market

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[1] The views expressed herein are Chairman Breeden's and do not necessarily represent the views of the other Commissioners or the Commission staff.

capitalization more than doubled over the decade, rising from $1.4 trillion to $3.4 trillion. However, other major capital markets did better in terms of growth. Measured in terms of growth in equity capitalization, the U.S. ranked only 16th among major markets. At the beginning of the decade, the U.S. equity market was 4 times larger than its nearest competitor. By the end of the decade, the markets of the U.S., Japan and the European Community were equivalent in size. Therefore, at least from a liquidity perspective, the substantial advantage of U.S. markets disappeared in only a decade.

However, competitive challenges raised by the growing trend toward global markets come at a critical point in our history -- a time when international competition is intense, and financial markets are undergoing far-reaching change. What these figures tell us is fairly simple -- in the 1990s we may not rest on our laurels, but must make every effort to ensure the continued liquidity and efficiency of our capital markets.

The Commission is determined to help the United States meet the competitive challenges in capital markets over the next decade. To this end, the Commission has proceeded on a number of fronts to remove unnecessary impediments to the free flow of capital.

III. COMMISSION INITIATIVES DESIGNED TO BRING THE U.S. CAPITAL MARKETS INTO THE TWENTY-FIRST CENTURY

A. Eliminating Structural Impediments to Capital Raising and Investment in the U.S. Equity Markets

Regulation can enhance the effectiveness of our capital markets by providing a stable and predictable environment in which to conduct business and pursue investment goals. Conflicting regulatory schemes, on the other hand, create structural impediments to investment that ultimately may cause serious damage to our capital markets. U.S. regulatory complexity drives up costs, delays the introduction of new products and generally adversely impacts competitiveness. The IPs decision, for example, is a death sentence for U.S. creativity. This is a self-inflicted wound, and only U.S. companies incur these unnecessary costs.

Another enormous barrier to market liquidity and efficiency stems from the present fragmentation of regulation of equity-based products between the SEC and the Commodity Futures Trading Commission ("CFTC"). The separation of regulation of equity securities from regulation of derivatives on those securities adversely affects the stability of our nation's markets by allowing the stock index futures market to run on leverage as high as 97.8%. The futures industry argues that this hyper-leverage hasn't caused a devastating stock market crash -- <u>yet</u>. I don't think there is a <u>serious</u> argument that can be made for leaving the protection of the U.S. clearance and settlement system to the boards of directors of the futures exchanges. Indeed, in Japan, France, the U.K. and other markets with stock index futures, margins are subject to oversight by a public agency, and a single agency has ultimate authority over stocks, options and stock index futures.

Our dual regulatory system imposes costs on financial firms and issuers that are uniquely American. Every other competitor nation with a developed capital market has avoided these costs by consolidating regulation of stocks, options, and stock index futures under a single government agency. Unlike our competitors, the U.S. has erected the financial equivalent of the Berlin Wall between regulation of securities and regulation of derivatives on securities. As a result, U.S. firms like Shearson or Merrill Lynch that want to offer customers products in stocks, options, and stock index futures must pay to maintain two entirely separate systems of regulation, and comply with the rule books of two entirely separate agencies. Nomura and Daiwa do not have to do that in Tokyo, and S.G. Warburg and Morgan Grenfell do not have to do that in London.

The exclusivity provision of the Commodity Exchange Act has subjected U.S. firms to expensive and wasteful litigation. By forcing our companies to test their products in the courthouse rather than the marketplace, the exclusivity clause has prevented potentially valuable products from trading in the U.S. For example, index participations ("IPs") were banished from our markets, following an unfavorable ruling by the Seventh Circuit. Other hybrid products have been deterred or driven offshore.

As the EC moves to integrate its financial markets and to dismantle all of its internal barriers, it appears likely that European banks and financial firms will be able to acquire a "passport" to operate throughout the EC by complying with home country regulation that meets minimum EC standards. Wouldn't it be nice if PaineWebber, Dean Witter or Morgan Stanley could obtain a passport from a single U.S. regulator that would allow trading on both the CME and the NYSE and would permit the sale of products from New York to Illinois to California?

The SEC/CFTC jurisdictional split has hampered the enforcement of both the securities and commodities laws, since it is more difficult for both agencies, even through regulatory cooperation, to detect and prevent market abuses such as intermarket frontrunning and manipulation. Unfortunately, we have two different policemen patrolling each side of our Berlin Wall on foot, while those seeking to engage in fraud are free to fly above the wall by helicopter.

A third area of regulatory fragmentation relates to the impact on our national markets of state securities and corporate takeover laws. Compliance with fifty sets of state blue sky laws can add significantly to the cost of raising capital in this country for small and medium size businesses. The states unquestionably have a central role to play in protecting investors from fraud and in regulating the affairs of the corporations they charter. However, the states and the Commission must work closely together to prevent the imposition of needless registration or other regulatory expenses that serve only to inflate the cost of capital.

One of the principal ways in which the Commission has fulfilled its mandate to maintain fair and open <u>national</u> securities markets has been to protect fundamental shareholder rights. Shareholders will little benefit from the Commission's efforts to protect them from insider trading or other fraud if their investments can be devalued by state statutes and judicial decisions that insulate management from accountability to shareholders -- the people who, after all, <u>own</u> the business. However, actions increasingly being taken by state legislatures and courts to reduce the accountability of managements and directors to shareholders may significantly reduce the attractiveness of equity investment.

An obvious example of this problem is the "disgorgement" statute recently adopted in Pennsylvania, which could do serious harm to shareholders' federally-protected right to use the proxy machinery to replace corporate boards. The adoption of such statutes, which is often driven by parochial attempts to protect the management of a local company, may have broad consequences. To illustrate, new Massachusetts legislation hastily adopted to help a Massachusetts corporation fight a hostile foreign bid significantly curtails the efficacy of the shareholder franchise by imposing staggered boards of directors on all companies incorporated in that state. That statute failed its purpose of shielding a particular company almost immediately, yet the law will stay on the books and harm shareholders for an indefinite period.

So-called "multiconstituency statutes" adopted by Pennsylvania and other states may compound statutory disincentives to invest by permitting boards of directors to entrench themselves by treating the interests of non-shareholder groups as paramount when confronted with an unfriendly acquisition offer. If this trend toward erosion of traditional corporate accountability mechanisms becomes a "race to the bottom" among the states, it has the potential to damage substantially the benefits of owning stock. This would, in turn, undercut the essential liquidity and efficiency of our national capital markets.

To ensure that shareholders continue to have an active role in corporate governance, the Commission is now reviewing the shareholder voting and proxy process. In connection with that review, the Commission is giving serious consideration to a thoughtful proposal for reform submitted by CalPERS last November. The CalPERS proposal recommends restructuring the proxy rules to:

- establish secret shareholder balloting and independent vote tabulation;
- afford shareholders an opportunity to influence the agenda for voting in the election of directors and other fundamental aspects of corporate governance; and
- establish clear guidelines to permit shareholders to communicate among themselves without fear of violating the proxy rules.

At the heart of this proposal, and others that have been advanced, is a strong concern that management is free under the current system to dominate the proxy agenda and voting process. The Commission appreciates the gravity of these concerns, and intends to review carefully the proxy process during the next few years. More importantly, we will try to speak up concerning the need for protecting the national interest in a national marketplace.

B. Commission Regulatory Initiatives to Enhance the Competitiveness of the U.S. Equity Markets

America's primary challenge in the 1990s and beyond will be to compete effectively for capital in the global securities markets. To help America compete, the Commission has taken a number of steps to enhance the efficiency of the capital-raising process within the U.S. markets. Last month, for example, we expanded both domestic and foreign investment opportunities in our markets through the adoption of Rule 144A.

Rule 144A's adoption marks the end of an eventful decade that began with the Commission's implementation of a shelf-registration system that has operated to decrease substantially the cost of public securities offerings. Rule 144A is expected to bring comparable efficiencies to the already thriving U.S. private placement market by enabling restricted securities to be resold freely in this country to qualifying institutional investors. The dramatic growth in the size of the U.S. private placement market, which increased from an estimated $67.1 billion in 1985 to $170.4 billion in 1989 and totalled $643.2 billion over the past five years, suggests that the potential cost savings to issuers may be substantial.

On the same day that it adopted Rule 144A, the Commission also adopted Regulation S. This regulation provides for the first time a Commission statement on the extraterritorial scope of the registration provisions of the Securities Act. By establishing a safe harbor for securities offerings and resales outside the United States, the Commission has furnished a roadmap -- with clear guideposts -- that should eliminate the need for complex and costly procedures previously used to assure that U.S. registration requirements did not apply.

Today, inconsistent registration and disclosure requirements, accounting principles and auditing standards raise substantial barriers to a truly global securities marketplace. In response, the Commission has developed a variety of innovative approaches designed to minimize regulatory obstacles to the flow of capital across national boundaries without compromising investor protection. The most significant is the Commission's proposed multijurisdictional disclosure system. Under the proposed system, eligible issuers would be permitted to sell or exchange securities in any participating country using disclosure documents required by the issuer's home country.

Another challenge posed by the globalization of the securities markets is the increased U.S. investment in foreign securities, and the resultant need to assure the participation of U.S. investors in multinational rights offerings and tender offers. Foreign bidders and issuers frequently are dissuaded from extending such offers to their U.S. shareholders by the expense and time typically required to comply with an additional set of regulations.

Discriminatory treatment of U.S. shareholders in multinational cash tender and exchange offers concerns the

Commission. U.S. investors not only are deprived of the opportunity to realize significant value on their investments in foreign securities by tendering into a favorable offer, but also must decide whether to sell their shares in the secondary markets without the disclosure and procedural safeguards afforded by either the U.S. or a foreign regulatory scheme. The Commission will shortly publish a concept release that will solicit comment on the possibility of allowing foreign cash and exchange offers to proceed in this country pursuant to the home country's disclosure and procedural rules, although subject to federal antifraud provisions, where the U.S. ownership is <u>de minimis</u> and the home country's regulation is adequate to safeguard U.S. investors.

IV. COMMISSION INITIATIVES DESIGNED TO ENSURE INVESTOR CONFIDENCE IN, AND THUS ENHANCE THE COMPETITIVENESS OF, THE U.S. CAPITAL MARKETS

While striving to achieve both flexibility and innovation in applying its rules, the Commission is determined to protect investor rights under the federal securities laws. In my view, the Commission's efforts to protect investors will help make U.S. equity markets internationally competitive. Only through full and fair disclosure -- the cornerstone of our capital markets -- will our markets continue to attract both domestic and foreign capital.

The Commission is committed to pursuing an aggressive and comprehensive program to enforce the federal securities laws. The success of that program is evidenced by the recent criminal and civil prosecutions of Dennis Levine, Ivan Boesky, Michael Milken, and Drexel Burnham Lambert. These cases, in which over $1.3 billion was recovered, dramatically illustrate the government's ability and determination to reach all securities violators, even the most wealthy and powerful, who seek to enrich themselves by defrauding investors.

An area of investor protection that ranks high on the Commission's enforcement agenda concerns the effective regulation of disclosure by financial institutions. One of the great tragedies of the thrift industry crisis has been the level of fraud and criminality of many entrusted with managing federally insured institutions, resulting in massive losses to the public. To guard against fraudulent financial reporting, I have charged two newly created task forces -- one in the Division of Corporation Finance and the other in the Division of Enforcement -- with carefully reviewing the financial statements of financial institutions.

Another area of vital interest relates to penny stock fraud. In addressing this problem, the Commission has adopted Rule 15c2-6, the "cold-calling" rule, and has offered vigorous support on Capitol Hill for proposed legislation that would target penny stock fraud for extinction. The Commission also has urged Congress to pass the Securities Law Enforcement Remedies Act. This important legislation would:

- authorize federal courts to order the payment of civil money penalties;
- authorize the Commission to order disgorgement and impose civil penalties in certain administrative proceedings;
- authorize the Commission to issue temporary and permanent cease and desist orders; and
- authorize courts to grant the Commission access to grand jury information for use in enforcing the federal securities laws.

Adoption of the Enforcement Remedies Act would significantly enhance our ability to deter fraud by adding to the Commission's enforcement arsenal the ability to act quickly to stop ongoing illegal activities, as well as the authority to seek and impose penalties that represent significant economic costs.

To help ensure continued investor confidence in the integrity of U.S. securities markets, the Commission urges prompt adoption of the Market Reform Act. This legislation would, among other things, provide the Commission with critical information on how broker-dealer holding companies fund their operations, allocate their capital, and manage the risks inherent in their business. The need for this legislation was dramatically underscored recently by the sudden collapse of Drexel Burnham Lambert Group, Inc., the holding company parent of the Drexel Burnham broker-dealer firm. That failure was handled smoothly and without loss to the public. However, for the future we need to know if problems of that kind are developing in a company.

V. CONCLUSION

Shareholder confidence and participation in the U.S. capital markets is critical to ensuring the vitality of those markets. These markets are in turn essential to a stronger, more competitive America. The Commission will do everything it can to promote healthy and vibrant U.S. capital markets. If we do these things and do them well, we will face the 1990s and the decades to come with confidence.