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News Release

REMARKS OF

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It is a pleasure to be here with you today as you consider the past and future role of the U.S. securities industry in a global marketplace. With a market value exceeding $3 trillion, the U.S. equity securities markets remain the largest and most dynamic in the world. With total capital of $39.3 billion, the United States securities industry is also among the world's largest. Eleven of the 25 largest securities firms in the world are headquartered in the United States. Many of the world's most sophisticated financial firms are U.S. securities firms.

Despite its obvious strengths, however, the U.S. securities industry has entered a very difficult period of retrenchment after a number of years of spectacular growth. This recent period has been marked by sharp decreases in revenue in virtually every profit sector of the industry.

As a result, the industry's recent profit performance has been poor, to say the least. As you know all too well, profit margins have fallen to almost the lowest level since 1973-74, and return on equity has dropped to less than 2%. Aggregate employment in the securities industry is far below its 1987 high.

To some extent, the recent difficulties of the securities industry are merely the predictable effects of the business cycle, which traditionally has taken the securities industry to higher highs, and lower lows, than other industry segments. Recovery may be somewhat more difficult this time, because we are facing adjustment to both the business cycle and to correcting the distortions caused by a speculative debt binge in the late 1980's. Returning to healthy profitability will also have to overcome the heavy burden that increasingly outmoded federal and state legislation places on your ability to pioneer new products or simply to operate in traditional markets.

The securities industry's financial troubles are, of course, part of a more general downturn in the financial services sector. Indeed, the banking industry has also experienced very painful problems in recent years. From 1985 through the first quarter of this year, FDIC insured banks were forced to absorb more than $80 billion in loan write-offs and provisions for loss. This sum represents approximately 40% of the aggregate capital of all U.S. banks. More than 1,000 banks and thrifts have failed during this time -- compared with only a handful of broker-dealers. For the period 1985-1988, the return on equity of U.S. banks was dead last among those of the top seven industrialized nations. Sadly, more

than 80,000 investors have lost well over $5 billion in equity investments in banks and thrifts during this time.

The manifest distortions permitted by current bank accounting policies has helped to hide bank financial problems, rather than to portray them accurately for investors. This, together with massive losses suffered by bank investors, has limited the ability of banks to raise fresh equity capital through the markets. Today, only one U.S. bank is among the 25 largest banks in the world. This fact should not be entirely surprising since the U.S. is the only major nation in the world to prohibit national banking and national securities operations.

It is all too easy to focus on the negatives facing our economy, the banking system or the securities industry. However, there is great fundamental strength, and great resilience, in our capital markets. The U.S. banking and securities industries are extremely innovative, and capable of effective global competition. Large amounts of capital, significant managerial resources and other factors also are important strengths for U.S. banking and securities firms.

Therefore, I am optimistic about the ability of U.S. financial services companies -- and the U.S. securities firms in particular -- to weather the current securities market downturn. Indeed, since January 1, despite widespread fears of a recession and

difficulties producing a federal budget, despite skyrocketing oil prices and the possibility of war in the Persian Gulf, the U.S. securities markets have outperformed most foreign securities markets, including the Japanese, British, French, German, and Canadian stock markets. Our comparative performance during a difficult year is a testimony to the core strength and competitiveness of our markets. It also suggests that the record of many decades in which securities investments offered the public the best return on savings was not an accident, and that long-term savings and investment in equity securities by the public can and should be encouraged.

To restore the profitability of the financial services industry, however, we will need to do more than merely wait out the business cycle. We will have to act vigorously to remodel the archaic legal structure of our financial marketplace. This will require rewriting an entire spectrum of federal and state laws governing our financial institutions. A major advantage in completing this difficult and complex task will be the leadership of President Bush, Secretary Brady and the Treasury Department. The thorough study that they will soon be completing should provide the intellectual and policy framework for a bold initiative to restructure -- and revitalize -- America's financial markets. I certainly look forward to working actively with the Treasury as this vital undertaking moves forward.

Of first importance in this effort should be the reduction of arbitrary barriers to the activities in which financial institutions, including both banks and securities firms, are permitted to engage. To do that, the Bank Holding Company Act, the Glass-Steagall Act and the Commodity Exchange Act should be revised.

The Bank Holding Company Act currently operates as an "exclusionary rule" to prevent most U.S. companies from buying U.S. banks. By disqualifying the great majority of U.S. corporations from investing in the banking business, this statute significantly limits the capital that is available for investment in banks. At a time when banks and thrifts are being asked to build up their capital bases, this type of artificial restriction operates at cross-purposes to national economic interests.

General Electric, Prudential Insurance, American Express, and Sears all own securities firms, and their relationships with their broker-dealer subsidiaries have been valuable to those broker-dealers and to the industry as a whole. Why, then, should we prevent non-banking firms from contributing their managerial, organizational, and financial talents to the banking business, as well as their capital?

The Bank Holding Company Act's tradition of intensive holding company regulation also should be revised. The BHCA now requires

the prior approval of the Federal Reserve Board before a bank holding company may engage in any acquisition or new activity. This type of intrusive regulation has not been effective in preventing failures of banks owned by holding companies -- and it removes decisionmaking power from the business organization. Since this "trickle down" approach to regulation has not been effective at controlling risk, I would suggest that most "regulation" should be focused on the operating bank, not the parent holding company.

The public interest certainly requires that we monitor the financial condition and control the activities of banks that are backed by federal deposit insurance. The banking system would be fully protected with four basic measures: (1) regulating the bank subsidiary, (2) building appropriate firewalls between the bank and its holding company affiliates that at a minimum would control dissipation of the capital of the bank, (3) requiring the bank to maintain a strong capital base, and (4) having the ability -- including realistic accounting standards -- to determine when a bank's true capital position has been eroded below minimum levels and to intervene to close or sell a bank before it has accumulated a significant negative net worth.

I have been focusing on the banking system thus far but, as we all know, there are also some areas that are badly in need of revision in the securities world. First, the dual federal-state system of securities regulation is badly in need of an overhaul.

In the United States, blue sky laws impede the capital-raising process by requiring issuers to submit to prior review by as many as 50 different state regulators, as well as the SEC, before bringing their securities to market. This system works well for enforcement purposes, but the logic of the system is less compelling when fifty different sets of state regulators are pouring over a registration statement that has already been cleared by the SEC.

In contrast, our competitors in Europe are moving to eliminate overlapping securities registration requirements. As a result, unless this situation is reversed, it may be easier and cheaper in two years' time for a German bank to distribute the stock of a U.S. company throughout the 12 E.C. countries than for a U.S. underwriter to make a comparable distribution for a U.S. company in California, Texas or Illinois.

Another issue in need of a good overhaul is the Investment Company Act of 1940. As you may know, earlier this year I directed the Commission's Division of Investment Management to conduct a thorough review of the '40 Act. Early in the next year I anticipate receiving a series of recommendations on the ways to achieve greater efficiency in the regulation of investment companies and other types of pooled investments without sacrificing essential safeguards.

Another facet to the long-term health of the financial services industry is public confidence. Public confidence is absolutely essential to strong and vibrant markets. Without public confidence, even the most well-organized and well-run markets will not achieve profitability.

Some preliminary steps to preserve public confidence in the integrity and stability of our financial system have already been taken. This fall, President Bush signed into law the Market Reform Act of 1990. With the new authority contained in that statute, the Commission will be able to monitor the activities of broker-dealer holding companies in order to ensure that those activities do not pose unacceptable risks to the regulated broker-dealer. In addition, the legislation gives the Commission the authority it needs to obtain information about the trading activities of very large traders, something that will help us conduct more effective market surveillance so that we might soon understand the causes of sizeable market moves better than we do today. Finally, the bill provides mechanisms to encourage the development of a uniform set of laws on clearance and settlement.

As you all know, President Bush also signed the Securities Enforcement Remedies and Penny Stock Reform Act of 1990, which gives the SEC ñew power to impose fines against securities law violators and to address fraud and abuse in the market for penny stocks. With this new authority, the Commission will be able to

hurt securities law violators where it matters the most -- in their wallets. If punishment is swift, certain, and expensive, we will be able to take much of the financial incentive out of securities fraud. These important statutes add significantly to the powers and responsibilities of the SEC. They would not have been enacted without strong leadership from Congress, especially the vigorous role played by Senators Chris Dodd, John Heinz, Don Riegle and Jake Garn, and Congressmen Ed Markey, Matt Rinaldo, John Dingell and Norm Lent, among many others.

Taken together, these statutes give the SEC important new tools to shore up investor confidence in the markets. However, we have not yet finished the job. One particular area of concern is the fragmented system for regulating the markets for stocks, stock options, and stock index futures -- markets that operate economically as if they were one market, but that are regulated almost as if they were entirely unrelated. The Administration proposed a bill to address this situation, which was sponsored by Treasury Secretary Brady and had the support of the President. At the end of the session last year, the leadership of the Banking and Agriculture Committees in the Senate reached a compromise that would have responsibly addressed the problem of dangerous leverage and self-destructive litigation over the so-called "exclusivity clause" of commodities regulation, while making no change in agency jurisdiction. Even this very reasonable compromise proposal was unfortunately vigorously opposed by the Chicago Mercantile Exchange

and the CFTC. President Bush has stated that he strongly supports the Administration's original legislation, and that Congress should "complete the job of market reform by enacting the Administration's bill."

Despite the debate, as we meet this morning the futures exchanges still have the authority to adopt any degree of leverage for stock index futures, and the Commodity Exchange Act still establishes a wall blocking the development of new hybrid products by securities exchanges and U.S. corporate issuers. The futures exchanges have fought hard for the right to drive an 18-wheeler down America's financial highway and to remain immune from speed limits or safety laws while they do it.

In order to preserve public confidence in our nation's securities markets, we must also ensure that those markets operate safely and efficiently. To do that, we must reduce the level of risk associated with the clearance and settlement process.

Although the United States securities markets provide investors with one of the strongest, safest, and most efficient clearance and settlement systems in the world, our clearance and settlement system may still contain an unacceptable level of risk. Indeed, a failure of the clearance and settlement system is not unthinkable. The market breaks of October 1987 and 1989 demonstrated graphically that, during severe market conditions, the

value of a market participant's securities positions can change suddenly, perhaps enough to force the participant to default on unsettled positions. Because of the interdependence of financial intermediaries, the loss of funds or securities due from a defaulting financial institution, even on an intra-day or overnight basis, could swamp other financial institutions who made other commitments in anticipation of those funds or securities, thereby causing them to default as well, with a cascading effect on still other financial institutions.

One way to reduce systemic risk would be to shorten the settlement cycle and convert to the use of same-day funds for settlement payments, as the Group of Thirty has recommended. Earlier this week, the Commission hosted a roundtable discussion of the Group of Thirty's recommendations. After a productive and useful discussion, there was virtually unanimous agreement that the Commission and the Group of Thirty U.S. Working Committee should press forward with implementation efforts. The Working Committee promised to produce a list of implementation steps by the end of the year, and the retail brokerage community committed that it would produce, within three to six months, a recommendation as to how best to solve the problem of customer payments. I urge all interested parties to participate in this process within these self-imposed deadlines, because this is an issue the Commission intends to address in the coming year.

When and how we implement these recommendations, of course, will continue to be important issues, particularly with respect to retail investors and retail brokerage firms. I was heartened, though, to find widespread agreement among a broad range of industry participants that we must continue to strive to reduce systemic risk, and that improving our clearance and settlement system is essential to maintaining our international competitiveness.

One important way in which the SEC, the Treasury and the securities industry have demonstrated effective co-operation between government and industry -- that is, little need for government intervention and much initiative and creativity from industry leaders -- has been the installation of the so-called "circuit breakers" in the wake of the '87 market break. Since their adoption by the exchanges in 1988 following the Brady Commission Report, the circuit breakers have been activated almost two dozen times. As a result, the synthetic volatility of individual stocks and of the market as a whole has been reduced, which helps to restore confidence in the market not only of the individual investor -- the little guy so important to the marketplace -- but also of the institutional investors as well. Clearly, there is still much more to be done to fine-tune these procedures, especially in light of continued concerns regarding the trading volume of stocks as it relates to the triggering of the circuit breakers.

Finally, I would like to say a word about how the SEC has responded and will continue to respond to the growing internationalization of the securities markets. We believe that U.S. investors and issuers are best served by free and open competition, not only among firms but also among markets. For that reason, we have taken steps, such as adoption of Regulation S and Rule 144A, to make it easier for U.S. firms to compete in foreign markets and for foreign firms to compete in the United States.

Along these lines, the SEC has acted, in concert with the Treasury Department, to assist the development of emerging markets in Eastern Europe and the Third World. As part of this effort, the SEC has created an Emerging Markets Advisory Committee ("EMAC") composed of chief executive officers and other senior representatives from over 30 of the nation's leading financial market firms and organizations. The EMAC is working with us to advise countries concerning trading systems, clearance and settlement processes, techniques for privatization of industry and other important issues. Next April, the SEC will host a two-week International Institute for Securities Market Development in Washington. The Institute will be an intensive training course for foreign regulators and market officials in the design and operation of securities markets and their related operational and regulatory systems. We expect that several dozen officials will attend, from many different countries that are seeking to create or to

strengthen and expand securities markets, with experts from the public and private sectors serving as instructors.

We are taking these steps to help markets that will eventually become our competitors because it is the right thing to do. As these foreign markets develop, they will provide U.S. investors with valuable new investment opportunities. Over the long haul, U.S. investors will be best served if we have large and thriving capital markets that are the product of fair and robust competition.

Just over one year ago, I took office as Chairman of the SEC, and during that time the securities industry and the SEC have successfully co-operated on a number of issues. I have very much appreciated your help, advice, suggestions and, yes, from time to time, even your criticism. Of course, there is much left to be accomplished, especially in the areas of state regulation and streamlining of settlement procedures.

The equity market is the crown jewel of America's capital market. We at the SEC share your concerns about its current situation and its future and will exert our best efforts to work with you to create a stronger, fairer, more open and stable market environment that hopefully, for your sake, will allow you to compete freely and profitably. If the SEC and the securities industry share a sense of vision and co-operation, U.S. markets

will remain a source of pride, economic strength and stability: the envy of the world from Mexico City to Moscow, Bangkok to Budapest.