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(202) 272-2650

DYNAMIC CAPITAL MARKETS:
ONE KEY TO AMERICA'S FUTURE

An Address by
Barbara S. Thomas
Commissioner
U.S. Securities and Exchange Commission

Audit Bureau of Circulations
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I. Introduction

It is a real pleasure and a great honor for me to be in New York today to take part in this exciting event of the Audit Bureau of Circulations. Your theme, "The Will to Win," is one which is very consistent with the purpose of the SEC, which, like the Audit Bureau of Circulations, has the responsibility to require the provision of reliable, affirmatively disclosed facts and figures on which decision-makers can make those decisions with confidence that they have the truth before them.

Indeed, I feel very much at home as an SEC Commissioner speaking in New York City, not only because of the importance of our agency to the Wall Street community, but also because I've lived in N.Y. all my life until 2 years ago, when I went to Washington to serve in the government.

When I first arrived in Washington, many of the people I met seemed to know that I had been appointed to an important Commission. However, instead of asking questions about the issues I'd come to the SEC to face, such as corporate disclosure and insider trading, they would ask interesting but perplexing questions about direct broadcast satellite systems, cable TV and the AT&T settlement.

Finally, it dawned on me that Washington was very much a media town whereas New York is a business community, so that agencies like the FCC and the FTC were perceived as being the most significant, rather than the SEC.

Now, after two years in Washington, I've adjusted to the vagaries of geography. But coming from New York, where the SEC has a major presence in the midst of a vibrant corporate and financial community, I still sometimes marvel when new acquaintances in Washington express chagrin that I work only on the esoterica of corporate finance and stock market regulation, rather than other media-significant issues.

II. The Commission's Role

In keeping with the theme of today's meeting, "The Will to Win," I personally could not be more pleased with my fate in being appointed to what many consider to be the best overall government agency in the world!

That's easy for me to say, of course, and certainly may sound self-congratulatory, so let's look at the comments of the Financial Times, England's equivalent of the Wall Street Journal. Recently it sponsored a detailed study of the quantity and quality of the disclosure contained in journal reports from 200 different companies and it unequivocably concluded that the United States disclosure was indeed the best in the world.

Well, that's just the way it is meant to be. The statutory mandate of the Securities and Exchange Commission is very clear.

- -- to protect investors, and
- -- to maintain the integrity and efficiency of the United States capital markets.

As such, the Commission has played, and continues to play, a critical role in ensuring that America's capital is channeled toward productive investments, and that individuals are willing to invest in the future of America by purchasing stocks and bonds.

The similarities of the SEC and the ABC are many. To appreciate the SEC's role today, it is important to look back at its history.

Like the ABC, the SEC was created at a time of crisis. As most of us know, during the 1920's, this country went through a period of excessive speculation and investment in securities. Large numbers of unsophisticated investors, attracted by the promise of quick and certain wealth, speculated wildly in the stock market, many of them for the first time, often completely carried away by the ardor of those exciting, jazzy times.

Then, on "Black Monday," the spree came to an abrupt halt, with the Great Crash of 1929.

Thousands of people were destroyed financially, and many spiritually.

What happened? Congress was pressed to find out. And, in the subsequent investigation, evidence developed that showed that there had been widespread and flagrant fraud, misrepresentation, and manipulation in the securities market. Many people just like us had made major investment decisions without adequate, or even

even fundamental, information about the securities they were buying . . . and thus, they were easy prey for high-pressure salesmen and brokers.

Public outrage and deep depression brought Congress in 1933 to enact the Securities Act of that year, an Act which came to be known as the "truth in securities" law. It met the abuses head-on by prohibiting fraud and misrepresentation in the new issuance of securities by corporations.

Then, in 1934, Congress followed up with the Securities Exchange Act. This created the Securities and Exchange Commission as an independent agency. It went beyond the 1933 Act in prohibiting fraud in connection with the trading of securities. It also required certain companies to file periodic reports with the Commission detailing their current business and financial situations, which reports from the beginning have been publicly available to all interested persons.

If any of you has read the current best selling book, "Indecent Exposure," you'll remember the great attention and deference paid by some of the corporate officers of Columbia Pictures to the role of the SEC in disclosing improprieties within publicly owned corporations.

On that point, it is important to note that despite the disastrous results of the excessive stock speculation in the 1920's, the Commission and the securities laws it was created to administer, were not designed to bury the securities markets, but rather, to provide a fertile garden for their future growth.

Unlike the laws of many other countries and even of our own states, our federal securities laws merely require full disclosure -- they are not a merit system. By this I mean that they do not prohibit offering or trading of securities just because the investment appears to be risky or because we at the Commission believe the securities are otherwise unsound or without merit, nor does it give the Government authority to regulate the price at which the securities are to be offered or traded. The basic fact is that any company can go public so long as it fully discloses all material facts. The Commission, again like ABC, is not evaluating quality, but rather the truth and completeness of disclosure.

As most of you here this morning are in media or media-related businesses, I am sure that you will agree with the observation of Justice Brandeis in 1913 that "Publicity is justly commended as a remedy for social and industrial diseases. Sunlight is said to be the best of disinfectants."

Drawing upon this basic theme, we believe that if a company is required to make full disclosure about its operation, it is more likely to keep its own house in order, and to avoid questionable business practices such as self-dealing and conflicts of interest, the disclosure of which would certainly make it more difficult to raise capital in the public markets.

For my part, I believe the disclosure focus of our statutes is correct, and that the SEC has done its job efficiently and effectively over the years.

III. The Role of the Securities Market

In saying that the Commission regulates the securities markets, however, I have only touched on a small aspect of the Commission's role. Investors are called upon each day to exchange their real dollar income for pieces of paper with no more than a promise of a future return. Thus, in many ways, our securities markets are themselves a good barometer of the willingness of the American people to bet on their economic future. Indeed, because the securities markets are, in many respects, the very engine of American industry, I believe that their continuing vitality is, itself, an indication of the faith the American people have in their ability to subdue new frontiers.

A. Deep and Liquid Markets

In this connection, as I have said before, the United States capital markets have long been recognized, for a variety of reasons, as the best capital markets in the world! Perhaps most importantly in this regard is their extraordinary depth and liquidity. Deep and liquid markets mean that at any one time, there are so many buyers and so many sellers of outstanding securities in the market, that you can almost always find someone to buy or sell a particular security in almost any amount. In other words, an investor can generally be assured that he can readily convert his piece of paper into cash. Thus, investors are more willing to buy securities in U.S. markets because the market ensures that there will always be another investor willing to buy the securities from him when he wants to sell them. As a result of this active trading market, commonly called the secondary market, corporations are better able to sell, and investors are more willing to buy, <u>new</u> issues of securities by companies in what is called the primary market.

The relationship between the primary and secondary market is, therefore, an important element of raising new capital. For example, if a company were trying to raise new capital by issuing securities without the benefit of an active secondary market, we can assume that investors would be less willing to buy stock in the company because they would be less able to "cash-out" their investment at any time when they wanted to sell the stock in the secondary market -- that is, on the stock exchanges or in the over-the-counter market.

An additional important benefit of a deep and liquid secondary market is that such a market prevents "crowding out" of private capital. In contrast to the United States, the governments of many foreign countries often issue so many securities in their markets that almost all available funds for capital investment are absorbed by government financing efforts. Thus, private companies find that there is no more public capital left for them to finance their operations. This phenomenon -- called "crowding out" -- is generally not experienced in U.S. markets, where historically there has been sufficient capital for both governmental and private issuers alike. Indeed, recent efforts to reduce the federal deficit are, in part, motivated by the desire to reduce further the capital drain which may result from federal financing efforts.

In this connection, it is also important to realize that our highly liquid, and capital rich, markets have obviated the need for the government to limit the amount of capital raised in our markets during any particular time period. Rather, under our system, any issuer, foreign or domestic, can offer securities and raise capital in the U.S. markets by merely filing an appropriate disclosure document with the SEC, and by soliciting purchasers to invest their funds in the corporate enterprise.

In contrast, access to the capital markets is not as free in many foreign countries, where the limited sources of capital have forced those countries to monitor conditions in their markets and to control the capital-raising process. It is well-known, for example, that this type of governmental "guidance" exists in countries as diverse as West Germany, the United Kingdom and Japan.

B. The Role of the Individual Investor

The development of deep and liquid capital markets in the United States did not occur by accident. Indeed, during the nineteenth century, the American securities markets generally did not involve most segments of American society. Rather these markets were in many respects viewed as enclaves for the wealthy to use as source of speculation and sport. Only during the twentieth century, unfortunately before the Great Crash, did small investors begin to enter the market.

Indeed, the securities laws were enacted, in part, to provide a framework of public confidence so that the very investors who who were traumatized by the Crash would reenter the securities markets with confidence. Moreover, this effort was accelerated by the "Buy a Share in America" programs in the 1950's and the so-called "Go-Go Years" of the 1960's.

By 1981, over 30 million individual investors, representing 20% of the adult population, owned some amount of stock or bonds, either directly on a stock exchange or in the over-the-counter market, or indirectly, through mutual funds, employee benefit plans, or dividend reinvestment plans. In addition, institutional investors, such as insurance companies and pension plans, although representing their own interests, also act as surrogate representatives for millions of other investors. Thus, even though the absolute level of savings in the U.S. may be comparatively low, our savings are quickly and effectively transferred into the capital formation process. Even more importantly, perhaps, the widespread ownership of securities by individuals provides a method to ensure that the economic interests of individual investors and the business in which they invest are similar. In this regard, our securities markets not only provide the capital necessary to enhance future growth, but they also contribute to the political stability of our nation as a whole.

C. Innovative Markets

As a separate matter, it also should be noted that, as a result of this diverse investor population, the American financial community has had to respond to the dynamic and ever-changing needs of investors and the industrial corporations which rely on the securities markets. Rising to this challenge, the American financial community constantly has striven to design new, more flexible financing vehicles. From the creation of the negotiable certificate of deposit in the sixties, to the options markets and the money market funds of the seventies, to the financial futures of today, at each stage, the financial community has brought forth new products for individual and corporate clients. In this regard, American investors have always been well-served by a financial community prepared to respond to new problems, irrespective of whether those problems are the result of regulatory intransigence or changing economic circumstances. Accordingly, if the current disinflationary trend continues, I fully expect that the nation's financiers will design effective vehicles to allow the public to benefit from even this trend.

In addition to these many success stories, the U.S. securities markets also have been of tremendous benefit to small businesses and emerging companies by providing them with effective market access to capital for their growth and development. Such financing is, of course, especially important today because, as several recent studies have indicated, more often than not, the technological breakthroughs of the future are first developed by small firms.

Indeed, in contrast to the openness of the U.S. system, access to capital in many foreign countries is often controlled by a few dominant financial institutions. In West Germany, for example, several major banks dominate the money markets and greatly influence the allocation of German investment capital. Because these banks can control participation in the new issues market, yet rarely enter this market, young emerging companies must obtain financing elsewhere, often through private loans, rather than equity offerings. The difference between the financing opportunities in West Germany and the United States is manifested by the fact that only approximately 30 companies have gone public in West Germany since World War II, whereas over 1,000 companies went public in the U.S. during 1981 alone.

IV. The Best Markets in the World

This brief summary of the way in which the United States capital markets operate highlights one of the most important and unique aspects of them. Our markets rely upon and, in fact, encourage the broad-based participation of a large number of individuals in our public capital raising process. As such, it is especially critical that American investors receive a regular and continuous flow of current and accurate information.

In this regard, American companies generally have done an exemplary job of providing their shareholders, and the investing public in general, with detailed disclosure of all information relevant to an investment decision in a prompt and readable format. For example, even though over 9,000 companies file annual and quarterly reports with the Commission, and over 5,000 registration statements are filed with respect to particular transactions, these filings generate only a comparative handful of lawsuits concerning the information disclosed.

Indeed, as I said before, a world-wide comparison of the quality of disclosure by various companies, conducted by the

Financial Times, concluded that U.S. disclosure was the best overall.

But even beyond private industry's assessment of the quality of our disclosure, it is also important to note that the international regulatory community also looks to U.S. standards as the benchmark for fair and accurate reporting. In this connection, various organizations, such as the United Nations, the Organization for Economic Cooperation and Development, the European Economic Community, and the International Accounting Standards Committee ("IASC"), are working toward harmonizing the diverse international disclosure and accounting principles. In this effort, the U.S. standards have served as an effective guidepost to identify desirable lines of development.

In addition, many countries such as France, Italy, Brazil, Australia, and Venezuela have set up SEC-type models and have adopted laws that are similar to ours. It is also noteworthy that the rules of the London Stock Exchange specifically state that compliance with the U.S. requirements is sufficient to satisfy its normal domestic disclosure requirements.

Finally, looking to the most important test -- where do people invest their money -- it appears that the rest of the free world continues to rely on the political stability and economic health of America as providing a basis for future growth. Indeed, when considered as a whole, foreign direct investment in the U.S. was approximatley 90 million dollars in 1981 -- a record breaking 31% increase over 1980. Moreover, foreign governments and corporations regularly seek financing in the United States because the U.S. financial markets are one of the few financial marketplaces where relatively long-term financing is still available. In addition, because the U.S. and Canada continue to be one of, if not the most, important markets for consumer goods, many companies seek to raise equity capital here in order to finance their North American operations.

V. Conclusion

In the long run, however, I do not believe that regulation or disclosure can ever fully supplant, much less replace, the dynamic energies unleashed by free competition. Rather, I believe that our markets are the finest in the world, and will remain so because the genius of the American people continues to be their ability to find new avenues for growth. If we can't climb over the mountain, we go around it. If we can't go around it, we dig under it. If we can't dig under it, we fly over it. This will to succeed -- this will to win -- ensures our future financial success. As Faulkner said when he received the Nobel Prize "I believe that man will not merely endure; he will prevail."