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# CAN THE SEC HELP CAPITAL MARKETS?

Remarks by

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Commissioner

Securities and Exchange Commission

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At the time I joined the Commission in August 1973 we were in the midst of one of the most devastating declines in the securities markets in the memory of most of us and there was an enveloping concern with regard to the health of the securities industry, the state of securities markets, and the capital-raising capacity of the country. As securities prices declined it became increasingly difficult for companies to raise equity capital and increasing interest rates made debt an expensive luxury. Profits in the securities industry then and during most of 1974 were poor, a fact that was reflected in a continuing succession of securities firm failures. As the principal regulator of the securities industry and the securities markets, my fellow Commissioners and I were increasingly taunted with inquiries as to what we proposed to do to

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remedy this sorry state of affairs into which the capital markets and the securities industry appeared to have fallen. As I mastered some of the bureaucratic techniques, I tended to fling this question back at the interrogators and asked them what they thought the Commission should be doing. Usually the answers related to matters that really were beyond our responsibility, our ken and our power. It was suggested that the securities industry should have the opportunity to build tax-free reserves as banks and savings and loans did; obviously adoption of such a policy was a prerogative of Congress and beyond our power. It was suggested that there should be a reform of the capital gains tax, a course with which I am in deep sympathy, but again this was something for Congress to do, with initiative perhaps from the Administration. It was often suggested that to function effectively the industry needed _friendly_ regulation such as that enjoyed by the banking industry. I came to believe, as I believe now, that this suggestion was predicated upon a rather gross misunderstanding of the nature of bank regulation, the sort of problems that the Fed, the Comptroller and the FDIC are concerned with, and the rather substantial differences between the banking and the securities industry. I concluded that really what most members

of the securities industry meant when they spoke of "friendly" regulation of the banking authorities was the discreet quiet with which their regulatory activities were carried on. This difference was clearly identified by Dean Miller, Deputy Comptroller of the Currency for Trusts, who frankly identified the style of bank regulation as "covert" versus the "overt" regulation of the SEC. Usually when we find an errant member of the securities industry, we make our charges against them known. We are convinced that such course is good public policy and that the public is entitled to know the manner in which its agencies are conducting their business. The banking regulators, largely because they are concerned with constituencies beyond investors in banking institutions, have adopted policies somewhat at variance with ours. It is not my intention to engage in extensive debate with regard to the relative merits of these modes of regulation. I can say however that I detect on the part of the staff and the Commission no disposition to modify our style, respectful though we may be of our fellow regulators at the Fed, at the Comptroller's office and the FDIC.

As time went on and the pleas for Commission assistance to the industry and to the securities markets mounted, I must confess I became somewhat embarrassed and hopefully also thoughtful. I meditated at some length on what indeed the

Commission might do to alleviate the condition of the capital markets, assist the efforts of companies to raise money, and rejuvenate the securities industry. I usually came to the same conclusions that others did, namely, that most of the things which could be really significant lay outside our jurisdiction and our power. But the longer I meditated on this the clearer became a realization that I would like to share with you. There is something the Commission can do with regard to capital markets. It is not a new idea - in fact it is 40 years old. It is not revolutionary - unless your notion of revolution harks back to New Deal days. I concluded the best thing the Commission could do was that which Congress told it to do in 1934, namely, safeguard the integrity, the efficiency and the welfare of the securities markets in this country and assure that those markets are fully informed markets.

This is not a particularly new and certainly not a very exciting idea. And yet I think it is terribly important. I think its importance is realized if you contemplate the possibility that the Commission ceased performing this function. What would happen to the quantity and integrity of information available in the marketplace? What would happen to the high standards that now animate the securities industry - or at least the overwhelming majority of the people in it? Would the

markets be as efficient or trustworthy? Would the securities industry be as reliable? What would be the impact of such developments on the ability of American corporations to raise the capital they need? I would suggest to you that the result of such a departure from the Commission's historic role would be simply disastrous.

In 1934 - for that matter beginning in 1933 when the Congress adopted the Securities Act of 1933 with its comprehensive disclosure requirements in connection with the distribution of securities - Congress acted on the basis of conviction that full disclosure with regard to an issuer's affairs was an absolute necessity. To assure such disclosure the Commission was given a very firm mandate as well as very broad powers and through the 40 years of its existence the Commission has used those powers and responded to that mandate. I know it sounds terribly parochial to suggest this, but I would suggest that no agency in federal government has acted as consistently in pursuit of its statutorily mandated purpose as the Commission has. Surely in that time its vigor has varied, but it is hard to find any time in the history of the Commission when it has lost sight of its purposes and objectives as defined by Congress.

The effort of the Commission to assure integrity in our markets takes two related forms. We administer a sophisticated and comprehensive disclosure system and we enforce laws which command not only disclosure, but also forbid a vast variety of other misdeeds which affect investors and markets. Obviously these activities overlap, and in a sense perhaps they are in large measure one, since much of our enforcement activity relates to departures from compliance with the disclosure system. For the most part, however, such a dividing up is proper, since much of the disclosure is accomplished voluntarily by issuers who in many instances recognize the value of it and cooperate fully with the staff in effecting it smoothly and efficiently.

The disclosure system is never static, just as our markets are never static or still. New conditions demand new modes of disclosure. For instance, as conglomerates multiplied in number and complexity it became apparent that adequate analysis of them required extensive information concerning their sources of revenue and profit, a need that eventuated in the Commission's line of business reporting requirements. As the markets have become increasingly institutionalized, with ever larger amounts

of dollars at the discretion of trained analysts able to deal effectively with more sophisticated information, we have sought to have it furnished to them, hence the Commission's insistence upon such disclosure as information concerning lease commitments, compensating balance arrangements, and increased income tax data. Frequently the Commission is impelled to shore up disclosure requirements as events dictate; for instance, as has been apparent, we concluded that the misuse of corporate funds to finance illegally political campaigns in this country was information investors should have when assessing the quality of management, as they do annually in exercising their voting rights.

Similarly our enforcement activities reflect the times. The financial relationships and dealings that may involve something called a "security" as defined in the statutes the Commission administers are seemingly endless: whiskey warehouse receipts, commodity options, pyramid schemes, condominiums, even, in some instances, memberships in clubs if certain characteristics are there.

But these more exotic enforcement pursuits should not obscure the day-to-day policing of the conventional markets that is done day after day. We receive information of a strange and inexplicable upsurge in trading; we investigate;

we find someone privy to undisclosed information about an issuer has tried to turn his information into profit at the expense of the hapless. We discern the remarkable constant upward ascent of the price of a stock for no discernible reason; investigation turns up a concerted manipulative scheme little different from those which brought about the reforms of the early thirties. We hear of large amounts of stock working into the market with no indication of compliance with our registration requirements; often investigation finds illegal distributions by insiders, often coupled with misuse of inside information.

As a consequence of this activity I think it is fair to say that the securities markets of this country have the highest reputation in the world for integrity, honesty, disclosure, reliability and opportunity. As a consequence of the vigorous enforcement activities of the Commission and the self-regulatory agencies manipulations are extraordinarily rare. Corporations as a matter of routine and habit make disclosures with regard to their affairs that astonish entrepreneurs in other countries. We have computerized our surveillance so that any measurable distortion or unusual movement in the markets is quickly identified and the causes for it pursued. While I am sure that untoward amounts of inside information are utilized in securities trading, nonetheless we have made the penalties

for such chicanery harsh enough that anyone motivated by avarice will usually seek other outlets for his vice. Surely, there is no guarantee that anyone will always make money in our markets. However there is reasonable assurance that any losses will be the consequence of circumstances and factors other than manipulation, misuse of inside information, unavailability of corporate information, or other circumstances that are commonplace in other markets.

The Commission has pursued the goals of full disclosure and honest markets with uncompromising determination. There have been times when it has been suggested that the single-minded dedication has aborted or hindered the efforts of deserving issuers to secure financing. I am sure that has happened on some occasions. But I am equally sure that any departure from this single-mindedness of purpose would have led quickly to a deterioration of the standards in our markets and industry which are so important for the capital-raising function.

Virtually every step of the Commission's efforts to strengthen the disclosure requirements has been met with the assertion that the newly required information would be misunderstood by investors. Several years ago when I was practicing law I was intimately involved in the discussions that led to the Commission rules with regard to disclosures concerning the profitability of lines of business. I can remember vividly what was said at that time. Many businessmen asserted that any requirement that significant lines of business, their sales and profitability be disclosed, would lead to an avalanche of litigation, severe competitive disadvantages, both at home and abroad, and gross misunderstandings on the part of investors. None of these consequences occurred. The same sort of arguments were heard back in the 30's when the Commission mandated that cost of goods sold be disclosed as part of the financial statements included in registration statements. And the same arguments have been heard with regard to our proposals concerning the disclosure of interim results. If the Commission had harkened to these forecasts of doom in the past, your typical prospectus would be today quite similar to those that were common in the 20's: a single sheet of paper telling the

name of the issue, the name of the security, the name of the underwriter and little else.

Once we begin to shave the edges of our disclosure requirements because of the capital needs of an industry or a company, it seems to me that we begin a retreat from the policies which have made our securities markets strong, healthy, vigorous and attractive to individuals and institutions alike. If this justification for non-disclosure were carried out to its logical conclusion it could have been urged in 1970 that the Commission not compel Penn Central to disclose the perilous state of its finances lest it impair its proposed debenture offering and thereby the business and perhaps the entire structure of the railroad industry in this country. Simply put, it seems to me that if the Commission's disclosure requirements imperil a vital national interest and thus should be moderated, that is a decision Congress should make and not the Commission.

I return to where I began: it does not seem to me that the Commission has either the power, the expertise or the mandate from Congress to do more with respect to the assurance of health in the securities markets and the capital markets than preserve and protect their integrity and assure the honesty of those people who participate in them = and that, I assure you, is a full-time occupation for the 2,000 people at the Commission.

As a consequence of the abuses and insufficiencies that became apparent in the late sixties - the paper glut, the hazards to which the investing public was exposed by securities firm failures, the obvious creaking of the established machinery, both houses of Congress began intensive and extensive investigations of the securities markets. One of the principal foci of this inquiry was the operation of the self-regulatory mechanism. Congress' conclusions were that there was indeed sufficient merit in the system to justify its continuance, but that it was in need of extensive repairs. These they have made is the legislation now on the verge of enactment. The various self-regulatory bodies will continue to be privately owned, privately run, but their affairs will be much more subject to Commission oversight than before. The opportunities for Commission intervention in the self-regulatory process will be expanded, procedures will be refined, a large number of specific mandates will be laid on the self-regulatory authorities, and the Commission will be ordered by Congress to take specific measures with respect to the self-regulatory bodies, for instance, review their rules to determine the extent to which they are anti-competitive, especially insofar as exchange members are inhibited in seeking the best execution for their customers. In addition to all this the Commission is

execution of their transactions at the best price. In carrying out the mandate of Congress the Commission will continue to do that which I have suggested is the main contribution it can make to the solution of the capital crisis. To the extent that a central market system enhances the confidence of investors that they are securing the best possible deal and that they have the same opportunities for best price and efficient execution as large investors and institutions, they will more readily commit their resources to long-term capital commitments. And that is the good we all seek.

In short, I do not think the Commission should be deflected from its 40 year old Congressional mandate by the exigencies of the moment. Fidelity to that simple directive can do much for our capital markets as it has in the past.