Remarks of

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It's a pleasure to speak with you today. I will not try to anticipate the broad range of internationalization issues to be addressed during this conference. Instead, I would like to focus my talk on two critical policy factors which the Commission must address in evolving its regulatory program to respond to the internationalization of the securities markets.

<u>Competitiveness</u>

Ensuring the competitiveness of the U.S. securities markets and industry is a shibboleth which, in itself, is not useful in analyzing problems or identifying initiatives. It can be used as a bludgeon to hammer at all regulation with the simple-minded assertion that any regulation imposing costs will send securities business fleeing to other localities where they may operate unimpeded by tiresome regulatory requirements. Such arguments are powerful, but they have the unfortunate detraction of being untrue. At least with respect to equity securities, trading continues to search out liquidity and liquidity, with few exceptions, continues to repose predominantly in the home country market. While one cannot conclude that a home country primary market will forever be assured, the fervid assertions regarding the untoward impact of individual regulatory actions tends to be more dependent on ideology than reality.

On the other hand, regulators would be ill served to confidently conclude that over regulation can never push business off-shore -- the Eurobond markets remain as a continuing reminder to that fact. More importantly, regulators must be constantly alert to the possibility that adjustments in the regulatory framework can contribute to new opportunities for innovation in America's securities markets; opportunities that can ensure this nation's role as the primary innovator for the securities markets of the future. It is in this area that I would like to focus this talk.

In looking to where the competitiveness of our primary and secondary markets could be substantially improved, the clearest area lies in the initial sale and trading of registered foreign securities. U.S. securities exchanges and NASDAQ do provide liquid trading markets for a wide variety of ADRs of foreign issuers. Securities of many other significant foreign issuers, however, are not publicly offered or traded on an organized U.S. market because of the unwillingness of those issuers to comply with U.S. periodic reporting requirements. While U.S. institutions may have the opportunity to participate in private placement tranches of large foreign securities the desirability of holding such securities historically has been reduced because of resale restrictions and the resulting absence of a liquid secondary market.

Proposed Rule 144a, in conjunction with Regulation S, offer the potential for a dramatic departure from the present environment. I will leave for a later panel the proper description of those rules. Suffice it to say that they provide a regulatory environment that will permit an efficient institutional market for the offering and trading of unregistered foreign securities. There are many other aspects and implications of these rules not the least of which are speculative competitive impacts on sectors of the securities markets. Nevertheless, I note with some concern the absence of clear support for these proposals by the securities industry. I cannot identify any action that has a greater opportunity to increase the competitiveness of U.S. underwriting in international securities than the implementation of Rule 144a.

Opposition to the rule or even calls for delay in its adoption is not a position I believe the securities industry should arrive at lightly.

The second area of opportunity relates more directly to the secondary trading markets. As I expect I gave away in the opening of my talk, I see little likelihood that foreign markets will compete effectively with U.S. markets in U.S. securities during our traditional trading hours. Similarly, I see little opportunity for our markets to attract significant order flow from foreign markets in their primary trading hours. The dependence on liquidity and the resulting centripetal forces built into the world's equity markets are simply too strong -- no matter whether that home market employs an exchange or over-the-counter trading system.

At the same time, I believe that the present situation with respect to after hours trading is in much greater flux. Institutions may wish to effect transactions in securities after trading hours in the market for many reasons: because of news regarding the issuer or macroeconomic events, because the trade involves one or more foreign party. More recently, portfolio or program trades have been effected after hours based on U.S. market closing prices for a wide variety of purposes including the avoidance of execution problems arising from the Commission's short sale rule and restrictions on upstairs negotiations of index futures trades.

These trades are currently booked in London or other foreign markets, not generally because the other side of the trade originated there, but because exchange off-board trading requirements do not permit members to effect such transactions in the U.S. off an exchange and no U.S. exchange is open to accept the trade.

A trading system now being developed by the Chicago Mercantile Exchange and Reuters may offer a useful analogy as to how U.S. markets might better respond to the need for liquidity during after-hours periods. That system, referred to as Globex, provides an environment where quotations and orders can be inserted and where transactions can be effected automatically in the system. Similar systems, such as Instinet and the National Securities Trading System are presently in operation in the securities markets. While such systems only account for a small percentage of trading during U.S. trading hours, it may be that automated systems offer greater utility for the sporadic trading, which occur after hours. Such systems permit the exposure to contra party interest of individual and program orders thus increasing the possibility that they might be executed at superior prices. Moreover, such systems provide "locked-in trades" thus reducing the risk of comparison errors.

I certainly don't pretend to have the expertise to say whether the development of such after-hours system would be successful in recapturing after-hours trading volume in U.S. securities or encouraging the trading in foreign securities in the U.S. But I do believe that is an area that deserves serious attention from the major U.S. securities markets. Regulatory restrictions that impede the development of such systems also deserve to be carefully examined.

Risk Control

As important as increasing competitive opportunities for the U.S. securities markets may be, the most critical task facing regulators and industry participants is controlling risks in international securities trading. Internationalization has caused U.S. securities participants to dramatically increase the number and type of contra parties with which they deal and the complexity of the products they trade. I see two particular exposures in the present environment: unregulated entities and clearance and settlement.

Holding Company Regulation

Financial regulation for securities firms evolved from a very different philosophical premise then did banking regulation. Rather than looking towards the safety and soundness of the institution, the Exchange Act focused on protection of the investors, or customers, of the broker dealer. Accordingly, the rules attempt to ensure that customer securities are not misappropriated, and that the firm can be liquidated without loss of customer funds or securities.

From this philosophical premise it is not surprising that securities regulation looks inward only to the registered broker-dealer and attempts to build, in effect, a Maginot line to ensure that the firm does not jeopardize its customers. While true to the underlying philosophy of the Act, this insular approach may no longer be tenable in modern internationalized securities markets. Simply put, the failure of a Salomon Bros. or Merrill Lynch can have nearly as profound an impact on the U.S. financial system as the failure of Citibank. And we should not kid ourselves as to the ease in which Merrill Lynch, U.S. could borrow funds and meet its short term obligations if Merrill Lynch, London, or Merrill's Interest Rate Swap Affiliate cannot open their doors one morning.

The Commission took an initial step to address this concern by proposing legislation which would have given the SEC authority to collect key financial information regarding non-bank financial affiliates of U.S. broker-dealers. The information collected would not be used to increase the capital requirement of my broker-dealer. It would allow us, however, to identify more effectively firms with substantial exposures in their foreign and unregulated financial affiliates and therefore more effectively evaluate the risks a particular firm might be subject to during periods of market volatility as the October 1987 Market Break. At a minimum, legislation such as this would reduce the risk of the SEC being caught unprepared by financial problems of a major broker-dealer.

Clearing

No area more directly impacts the risks of securities firms operating in an internationalized environment than clearance and settlement. It is nice to identify value in a particular market, but if settlement is routinely delayed and there are not adequate provisions for the marking of contra parties than the risks may exceed the rewards.

The time has come for united efforts to implement minimum clearance and settlement standards for active trading markets. Among the critical areas are the need to standardize and reduce settlement periods (including in the U.S.); implement in all active trading markets automated book-entry systems which provide for both institutional and street side settlement, implement linkages among international clearing systems and provide that delivery vs. payment becomes the standard mode of settling institutional trades throughout the world.

Progress in the area of clearance and settlement must come primarily through the united efforts of broker-dealers, banks and other securities participants. If there is a role for government here it is to be supportive and to help build momentum towards a more efficient and less risky clearance and settlement system.

The purpose of this talk has not been to preview the diverse subject matter to be covered in the next day and a half. It has, I hoped underlined that there is significant action which both government and the securities industry can take to improve the competitiveness, efficiency and safety of the U.S. securities markets.