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**News
Release**

**THE SECURITIES AND EXCHANGE COMMISSION:
PROSPECTS FOR 1987**

Address to

The Association of Public Corporations

**Biscayne Bay Marriott
Hotel & Marina
Miami, Florida**

January 12, 1987

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Commissioner**

The views expressed in this address are those of Commissioner Grundfest and do not necessarily represent those of the Commission, other Commissioners, or the Commission staff.

Summary

In an address to the Association of Public Corporations, Commissioner Grundfest describes 1987 as potentially the most important year in the history of the Securities and Exchange Commission. Commissioner Grundfest identifies five factors that suggest the coming year may be the most active since the Commission was established in 1934.

1. The Commission's insider trading investigations will continue, as will the public debate over policy implications of the Commission's investigations.

2. The Supreme Court will hear at least four cases likely to yield important securities law precedents. The cases involve the definition of insider trading, the constitutionality of "second generation" state antitakeover laws, circumstances under which investors can be required to arbitrate brokerage disputes, and procedures for discovery in international securities litigation.

3. On Capitol Hill, legislative energy will focus on takeovers, regulation of insider trading, and regulation of the financial services industry, including a review of the Glass-Steagall Act and of the Bush Task Group recommendations. Legislation in any of these areas could have profound implications for the Commission and the securities markets.

4. The President's budget recommends a 32% increase for the Commission, from \$110 million to \$145 million. This increase will add to Commission staff, provide for modernization of many systems, and allow the operational start-up of EDGAR, the Commission's Electronic Data Gathering Analysis and Retrieval system.

5. In 1987, the Commission will reach a decision on the one share-one vote controversy, evaluate public comments on the tender offer concept release, implement regulations under the government securities bill, decide whether to issue new mutual fund advertising rules, adapt various rules to increasing internationalization of the securities markets, grapple with the perception of volatility arising from program trading and index arbitrage, and respond to a wide variety of other regulatory initiatives.

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It's a pleasure to be here in Miami this evening to address this meeting of the Association of Public Corporations. The beginning of a new year is traditionally a time for predictions about the year to come. Those of you who bet on Miami in the Fiesta Bowl are familiar, I am sure, with how dangerous the prediction business can be. Despite the risks involved in making any predictions--especially when the predictions are public, on the record, and likely to be recalled 12 months from now--I will tonight throw caution to the wind and hazard some forecasts about the securities laws and the Securities and Exchange Commission in 1987.

I do not come by these predictions easily, and I want you to understand the extraordinary research my staff and I have conducted in order to arrive at the predictions that I share with you. The most important aspect of our research was to identify the competition in the prediction business. We wanted to know what others were predicting for the coming year so that we could have a reasonable, objective benchmark against which to measure the success or failure of our own projections. Therefore, we naturally turned to the most widely read and frequently referenced set of predictions we could find for 1987: the January 6 edition of National

Enquirer, the newspaper with the "largest circulation of any paper in America."

Deep in the center of the January 6 issue, past the story about "560-Lb. Man Loses Whopping 370 Lbs. in Just 18 Months,"¹ past the "Exclusive Interview with Mother Teresa,"² and past the extremely useful "How to Tell if Someone's Flirting or Just Being Friendly,"³ is a two-page spread in which ten leading psychics reveal their predictions for 1987.⁴ Among the predictions are that:

"A major hurricane will strike Miami in September--toppling a high-rise office block;"

"Don Johnson will quit 'Miami Vice' and go on the road as a rock singer--backed by a group of Playboy Bunnies;"

"A massive White House investigation into UFOs will be launched after an entire fleet is sighted by thousands of fans at an open-air rock concert in northern California;" and

"Four of America's biggest rock stars will be indicted on charges of masterminding a multimillion dollar cocaine ring. They'll be arrested on stage during a huge open-air concert."

¹Collins, "560-Lb. Man Loses Whopping 370 Lbs. in Just 18 Months," National Enquirer, Jan. 6, 1987, at 2.

²"Exclusive Interview with Mother Teresa," National Enquirer, Jan. 6, 1987 at 5 (reprinted with permission of Gente magazine).

³Brown, "How to Tell if Someone's Flirting or Just Being Friendly," National Enquirer, Jan. 6, 1987, at 18.

⁴Potter and Baker, "10 Leading Psychics Reveal Their Predictions for 1987," National Enquirer, Jan. 6, 1987, at 32-33.

We don't know if the UFO's will appear at the same rock concert where the four arrests are scheduled to take place, but, if so, it's likely to be a tough ticket.

With the competition from my fellow prognosticators so clearly defined, I will now hazard my own, perhaps less colorful but possibly more accurate, predictions for the coming year. In particular, I predict that 1987 may be the most important year for the Securities and Exchange Commission since it was established in 1934. I reach this conclusion because of the combined effect of developments in the insider trading area, pending Supreme Court cases, potential legislation regarding takeovers, insider trading, and financial services industry regulation, the prospect of a dramatically increased SEC budget, the scheduled operational start of the EDGAR system, and significant pending regulatory decisions, including resolution of the one share-one vote controversy, a follow-up on the Commission's takeover concept release, and a variety of other initiatives. We are, I believe, looking at a very busy 12 months.

Insider Trading

Public attention is most clearly focused on the Commission's insider trading enforcement program. The enforcement actions we brought in 1986 against Ivan Boesky,

Dennis Levine, and numerous others⁵ have certainly made history, and I suspect that in 1987 the Commission's insider trading enforcement program will continue to receive substantial public attention.

The question that everyone asks about the Boesky investigation is, "When will the other shoe drop?"⁶ The answer is simple. "When and if you hear a thud." I cannot be more helpful than that.

For reasons that should be clear and understandable, it is impossible for the Commission to comment on the state of ongoing investigations. As we have previously announced, Mr. Boesky and Mr. Levine are cooperating witnesses. In addition, we continue to pursue other insider trading investigations that have no relationship to the Boesky and Levine cases. It would be imprudent for me to be any more precise in describing the scope of our investigations, or to suggest whether or when they might lead to enforcement actions.

I understand and appreciate that this "no comment" response to inquiries from the press and others does not

⁵The others include the so-called "Yuppie 5," five young professionals in their mid-20's, including a corporate associate at a large New York law firm, two arbitrage analysts, and a stockbroker; a psychiatrist who learned inside information in the course of treating a patient; Ilan Reich, a young partner at Wachtell, Lipton, Rosen & Katz; Ira B. Sokolow, an employee in the merger and acquisition department of Shearson Lehman Brothers; and Robert M. Wilkis, formerly of Lazard Freres & Co. and E.F. Hutton & Co.

⁶See Nash, "Wall Street Nervously Expects More Insider Shoes to Drop," New York Times, Dec. 6, 1986, at 39.

satisfy the intense public interest in learning certain details related to recent and ongoing investigations. Our silence also does not help deter unwarranted speculation. For example, a ritual has apparently developed in which rumors spread every Friday afternoon that the SEC will be holding a press conference at 4:30 to announce another insider trading prosecution. The fact that these rumors have repeatedly been demonstrated as false has not stopped them from spreading.

There is, however, a good reason for the Commission's quiet approach. Our primary function in the insider trading area is law enforcement. As a practical matter, it is impossible to conduct an insider trading investigation if certain details regarding the investigation are publicly known. Tonight, I would like to provide some insight into why the Commission follows a cautious strategy in connection with public discussion of ongoing insider trading investigations.

Sometimes, it is crystal clear that a particular piece of information must be treated confidentially. On other occasions, however, it is far more difficult to reach any such conclusion. For example, we may uncover a fact that appears relatively innocuous at the beginning of an investigation, but further discovery may reveal that the fact is actually quite sensitive and critical. Moreover, if that fact is disclosed prematurely, its value in the investigation could be materially diminished. In some cases, a premature disclosure may even help potential defendants avoid prosecution.

Therefore, because it can be extraordinarily difficult to predict which facts are likely to be sensitive, and because the consequences of a premature disclosure can be quite serious, the prudent course of action is simply to say as little as possible.

That isn't the only reason why the Commission refuses to discuss ongoing investigations. In some situations, there are legal constraints on our ability to disclose information. In other situations, partial disclosure in the course of an ongoing investigation may be unfair because it may make certain parties appear more or less culpable than they would seem in the light of a full record. Taken together, these and other considerations argue strongly for a cautious and circumspect approach to disclosures in the insider trading area. As a matter of policy, the Commission therefore generally refuses to confirm or deny, or otherwise comment upon, matters relating to ongoing inquiries, and will generally not even confirm or deny whether there is, in fact, an ongoing investigation.

The Supreme Court Docket

Insider trading cases are not the only litigation developments to expect in 1987. The Commission has a broad and active litigation program, and one of the unfortunate side-effects of the extraordinary public attention afforded recent insider trading cases is that it has overshadowed many of the Commission's other enforcement efforts, including our

financial fraud program. Interestingly, much of the action in 1987 will be before the Supreme Court, which already has an unusually heavy docket of securities law cases, and the leading case once again involves insider trading.

The Supreme Court has agreed to hear Foster Winans' appeal of his criminal conviction for trading on the basis of information about upcoming news stories learned while he was a reporter for the Wall Street Journal.⁷ The case, which will be argued early in the Court's 1987-88 term, is likely to establish important law regarding the definition of insider trading. In the long run, the Court's decision in this case may have a greater impact on the securities markets and the law of insider trading than either the Boesky or Levine settlements.

The Supreme Court will also hear arguments in CTS v. Dynamics,⁸ a case that raises important questions about the constitutionality of "second generation" state antitakeover statutes, and in Shearson/American Express v. McMahon,⁹ a case that presents fundamental questions about the circumstances under which an arbitration agreement signed by a customer of a brokerage house at the time an account is opened can prevent

⁷United States v. Carpenter, 791 F.2d 1024 (2d Cir.), cert. granted, 55 U.S.L.W. 3424 (U.S. Dec. 15, 1986) (No. 86-422).

⁸Dynamics Corp. of America v. CTS Corporation, 794 F.2d 250 (7th Cir.), probable jurisdiction noted, 107 S. Ct. 258 (1986) (No. 86-71).

⁹McMahon v. Shearson/American Express, Inc., 788 F.2d 94 (2d Cir.), cert. granted, 107 S. Ct. 60 (1986) (No. 86-44).

that customer from pursuing claims against a brokerage firm in federal court. In addition, the Court will hear this week oral arguments in the Aerospatiale case,¹⁰ a decision likely to define the procedures to be used by the Commission when obtaining evidence from abroad. This is an investigative consideration that is of substantial and increasing concern to the Commission in light of the rapid internationalization of the securities markets.

In addition to these four cases already scheduled for hearing, petitions for certiorari are pending in two other securities cases. Basic Incorporated v. Levinson¹¹ raises intriguing and potentially important questions about what constitutes material information in the context of merger negotiations, and AZL Resources v. Margaret Hall¹² presents questions about the basis upon which a corporation may be held liable for the conduct of a large shareholder purporting to act on behalf of the corporation.

The lower courts are also likely to be active in a wide range of securities law cases. In particular, I would not be

¹⁰In re Societe Nationale Industrielle Aerospatiale, 782 F.2d 120 (8th Cir.), cert. granted, 106 S. Ct. 2888 (1986) (No. 85-1695).

¹¹Levinson v. Basic Incorporated, 786 F.2d 741 (6th Cir. 1986), pet. for cert. filed, 55 U.S.L.W. 3153 (U.S. Aug. 23, 1986) (No. 86-279).

¹²In re Atlantic Financial Mgmt., Inc. Securities Litigation, 784 F.2d 29 (1st Cir. 1986), pet. for cert. filed sub nom. AZL Resources, Inc. v. Margaret Hall Foundation, Inc., 54 U.S.L.W. 3779 (U.S. May 19, 1986) (No. 85-1877).

surprised to see substantial litigation over the rules governing the apportionment of funds paid as disgorgement by parties settling insider trading actions. There is relatively little law in this area, and much of the law that exists is inconsistent and confusing. The \$50 million disgorgement by Boesky, which is available for distribution to potential claimants, will stimulate litigation over who is entitled to what share of that pie, and that litigation may well lead to important new precedents.

Closely related to this litigation are claims that already have been or are likely to be filed by corporate clients of investment banking and law firms. These are clients from whom inside information was misappropriated or who were owed the fiduciary duties breached by the inside traders.¹³ These clients claim that inside traders, as well as the investment banks and law firms that employed them, are liable for substantial damages that the clients suffered as a consequence of illegal trading. The claims in these cases are in addition to the claims of investors who traded either with or at the same time as the inside traders.

The amounts claimed in these "client complaints" can be quite substantial. For example, the prayer in FMC's lawsuit

¹³E.g., FMC Corporation v. Boesky, No. 86-C-9879 (N.D. Ill. filed Dec. 18, 1986); Anheuser Busch Cos. v. Thayer, No. CA3-85-0794-R (N.D. Tex. filed Apr. 26, 1985); Litton Industries, Inc. v. Lehman Bros. Kuhn Loeb, Inc., No. 86 CIV 6447 (JMC) (S.D.N.Y. filed Aug. 19, 1986). See generally Victor, "Firms Vulnerable to Insider Suits?" Nat'l L.J., Sept. 8, 1986, at 3.

against Boesky, Levine, Goldman Sachs, Shearson, and Drexel Burnham is for at least \$235 million.

The Legislative Front

Activity on Capitol Hill in 1987 is likely to be at least as hectic as activity in the courts. Significant legislative initiatives can be expected in the areas of takeovers, insider trading, and regulation of the financial services industry.

Takeovers have been subject to active congressional attention for many years, and numerous bills were introduced in the 99th Congress in an effort to regulate various aspects of the takeover market. Recent developments have only heightened congressional interest. These developments include targeted share repurchases which are often labelled "greenmail,"¹⁴ substantial share acquisitions outside the Williams Act,¹⁵ the spread of poison pills,¹⁶ proliferation of

¹⁴Some recent transactions have been labelled as greenmail in the popular press but would not qualify under various definitions of greenmail proposed in legislation introduced in the 99th Congress. Because of these definitional problems, I have put the conclusory, shorthand label "greenmail" in quotes and instead prefer to call these transactions targeted share repurchases, *i.e.*, share repurchases that are not open to all stockholders on identical terms.

¹⁵*E.g.*, Campeau Corporation's acquisition of a controlling interest in Allied Stores, Inc. less than 45 minutes after terminating its tender offer; Harold Simmons' takeover of NL Industries, Inc.; and Hanson Trust PLC's acquisition of a one-third interest in SCM Corp., enough to block a management-proposed leveraged buy out in response to Hanson Trust's tender offer.

dual class recapitalizations involving shares with inferior voting rights,¹⁷ continued concern by some that takeover activity is harmful to the economy, local communities, and employees, concern by others over the adverse consequences of management entrenchment, and a fear that recent insider trading prosecutions signal fundamental weaknesses in the takeover market, as well as in the ethics of the investment banking and arbitrage communities. Although numerous bills will be introduced and many hearings will be held, whether legislation will actually be enacted is a different question that depends on a delicate economic and political calculus that is quite difficult to solve. Currently, however, I see a danger that passion may prevail over reason, and that, in an effort to at least "do something" about takeovers, Congress may enact legislation that appears, on the surface, to address some takeover problems, but that at a more fundamental level does more harm than good.

Another interesting question has to do with the form of takeover legislation introduced in the 100th Congress. Will the serious proposals center on marginal changes to the structure of the Williams Act--changing a waiting period here, and a notification requirement there? Or, will Congress engage in a more fundamental consideration of the dynamics of

¹⁶See U.S. Securities & Exchange Commission, "Concept Release on Takeovers and Contests for Corporate Control," Part II, 51 Fed. Reg. 28096, 28098 (1986).

¹⁷See p. 16, infra.

the market for corporate control and, based on the experience of the past 18 years under the Williams Act, consider new approaches to takeover regulation that reduce the incentives for counterproductive defensive measures while protecting the healthy market discipline that results from beneficial takeover activity? Only time will tell.

Legislative activity will also heat up in the insider trading area. Hearings regarding the Boesky and Levine matters in particular, as well as insider trading in general, are a virtual certainty. The shape of the legislative proposals, if any, that may emerge from these hearings is difficult to predict because they will be influenced by the ebb and flow of events over the coming months. But, here too, the risk is the same as in the takeover arena--that, in an effort to at least "do something" about insider trading, Congress may enact legislation that appears, on the surface, to address perceived problems, but that at a more fundamental level does more harm than good.

The third area in which legislative activity is a foregone conclusion is the regulation of banks and other financial institutions. The walls between "banks" and "investment banks" erected by the Glass-Steagall Act and Bank Holding Company Act are crumbling. The regulatory structure that may have seemed reasonable in the 1930's is hopelessly anachronistic for the United States in the 1980's, and the market is gradually but inexorably increasing the pressure on

the federal government to adapt financial services regulation to new market realities. The pressure is particularly apparent at the administrative level where regulatory agencies, including the Federal Reserve and the Commission, are straining to adapt old statutory language to a new market environment. Among many other issues, Congress will be asked to consider: (1) the adverse incentives that result from a deposit insurance system that seriously distorts the risk-bearing attitudes of bank and S&L managements; (2) the pressures to allow commercial banks to engage in activities that have traditionally been reserved for investment banks, such as underwriting corporate securities; and (3) the problems raised by massive bank failures that threaten the solvency of government deposit insurance funds.

In addition, Congress will be asked to consider a wide variety of proposals contained in the Bush Task Group recommendations. To the Commission, the most important aspect of the Bush Task Group recommendations is the notion of functional regulation--the idea that all participants in the financial marketplace should be regulated equally and according to the function their products perform. Thus, when bank and brokerage products perform identical functions, they should be regulated identically. Functional regulation is a critical element of the level playing field that is absolutely necessary if our financial sector is to grow, unencumbered by artificial regulatory restrictions. The Commission has been

and will continue to be a strong supporter of functional regulation.

The Commission's Budget

An increase in the size of the Commission's budget is likely to be a further significant development in 1987. The Commission's fiscal year 1987 budget is about \$110 million. The President's budget for fiscal year 1988, introduced on January 5, calls for SEC expenditures of \$145 million. This \$35 million increase constitutes a 32% one-year surge in the Commission's budget, and carries with it significant implications for the future course of the Commission's activities.

A significant portion of this increase will be used to expand the Commission's staff. In particular, the Enforcement Division currently plans to hire approximately 50 more people in the next 18 months, a staff expansion of about 25% over the current staffing level of 206 slots in the Enforcement Division.

Another large portion of the increase will be allocated to the Commission's Electronic Data Gathering Analysis and Retrieval system, EDGAR. The Commission plans to award the operational EDGAR contract this year, and looks forward to the implementation of an electronic filing and disclosure system that will wean us and the market away from a nineteenth century paper-based filing system that is straining under the pressure of seven million pages of filings per year.

This proposed budget increase will expand the resources available to the Commission, and responds to critics who have claimed that the Commission simply has not kept pace with the growth of the securities markets. But rather than focus on the absolute size of the budget allocated to the Commission, the critical question is how well we manage the resources that Congress and the President allocate to us. History teaches that it is difficult to resolve problems by throwing money at them, and the securities markets are no exception to that rule. The key to the future is not so much that the Commission's budget has been increased; it hangs instead on how wisely we invest the resources entrusted to us so as to promote the efficiency of the Nation's securities markets.¹⁸ Quantity, we should remember, is often a poor substitute for quality.

Rulemaking and Other Proceedings

Within the Commission, activity in 1987 will also be hectic on the administrative front. The one share-one vote debate is now squarely in the Commission's lap. The Commission's decision, one way or another, is likely to have

¹⁸As I have elsewhere explained, the most effective way to promote fairness and investor confidence in the markets is to promote market efficiency. Accordingly, an emphasis on efficiency does not detract at all from the need to preserve and promote fairness and confidence. Address by SEC Commissioner Joseph A. Grundfest to the Sixth Annual Ray Garrett, Jr. Corporate and Securities Law Institute, "Enforcing the Securities Laws: A Search for Priorities," Chicago, Illinois, May 1, 1986, at 5-11.

profound implications for: (1) the capital structures of many publicly-traded firms; (2) the operation of the market for corporate control; (3) the scope of competition among the exchanges and the NASD; and (4) the scope of the Commission's authority, if any, to regulate corporate conduct through listing standards. Also pending before the Commission is further action on our June 1986 takeover concept release. That release sought comment on substantial share acquisitions outside the Williams Act, the growing number of poison pills, and the possible application of self-governance exemptions to various provisions of the Williams Act. Within the coming year, the Commission is likely to decide whether and how to pursue these three topics, if at all.

Internationalization is a theme that pervades virtually all aspects of the Commission's work. In 1987 the Commission is likely to become more assertive in adapting its regulations to the realities of the international securities markets in a manner calculated to facilitate capital formation without reducing the effective investor protections inherent in the securities laws.¹⁹ At the same time, we will continue our efforts to negotiate bilateral information sharing and enforcement agreements that are, I believe, a critical emerging element in the emerging international financial

¹⁹See, e.g., Quinn, "Redefining 'Public Offering or Distribution' for Today," Address to the Federal Regulation of Securities Committee of the American Bar Assoc., Annual Fall Meeting, Nov. 22, 1986.

marketplace. In addition, as required by legislation, the Commission will submit to Congress a report on internationalization and its consequences for the securities markets.

In our domestic markets, we will consider proposed regulations intended to make mutual fund advertising claims more accurate and understandable, and we will implement new regulations required by the government securities legislation enacted in October of last year. As many of you may remember, the government securities bill was enacted in response to the scandals caused in part by the collapse of ESM and Bevill, Bresler, Schulman. We will also continue actively to monitor program trading and index arbitrage developments with a careful eye on the market volatility--real or perceived--that may accompany such trading. We will, I hope, continue to be careful to separate fact from perception when assessing these complex, novel, and rapidly changing market developments, but we will not hesitate to recommend measures that may be able to limit volatility while preserving the efficiency of these critical derivative product markets.

We will also continue with active oversight of the accounting profession, and will press forward with consideration of measures that pass a reasonable cost-benefit standard for improving the quality of both audit work and financial reports. Further, as required by legislation, we will report to Congress on the possibility of an exemption

from registration requirements for certain debt issues that are highly rated and that are backed by appropriate insurance guarantees. In addition, there is a long and growing list of regulatory projects that we hope to implement in order to make our securities markets more efficient and fair, and reduce unnecessary compliance costs for all market participants.

Conclusion

In sum, if I've given you the impression that we will have our hands full in 1987, I've succeeded. Nineteen eighty-seven is shaping up as a year without precedent in the Commission's history. Activity is likely to be fast and furious on many fronts, and it will take a steady hand in Congress, before the courts, and within the agency to steer us through the predictable crises as well as the inevitable unforeseen events that will undoubtedly complicate life even further in the next 12 months.

Thus, it's easy to predict an exciting year. Will it be a successful year? As for that, I can only leave you to judge, at about this time, next year.