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THE STATE OF THE SEC

An Address By

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Securities and Exchange Commission

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PLI CONFERENCE
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One of the reasons I accepted my position as Chairman of the Securities and Exchange Commission was that my appearances on the private-practice-lecture-circuit had become a bit too demanding and I thought it might be nice to settle down, finally, in a job where I would have no alternative but to sit at my desk, help shape policy and leave the speech-making to others. It hasn't quite worked out that way. Notwithstanding the rather frenzied importuning I receive almost daily from the members of my staff, in the last six or seven months I seem to have been talking publicly more than ever.

We had a gathering of the old boys last evening, a discussion period and dinner for all of the available former Commissioners, plus some former staff members. Manny Cohen organized it all, and it was great fun. Some 13 former Commissioners made the scene, along with such former staffers, from what they like to regard as the "Classical Period," as Milt Freeman, Milt Kroll, Allen Throop, Mort Yohalem, Louis Loss, and Harry Heller. The Classical Period has not been defined with precision, but there are certain ways to establish a claim to have been part of it. You can imagine the intensity of the oneupmanship -- the little ways of

calling attention to the superiority of one's own credentials -- the counter-expertising by one Classicist of another through correcting his story in mid-flow or suggesting that his related experience was nothing compared to that of old Seymour, now long gone, possibly even nonexistent ab initio.

You can scarcely qualify as first best in this competition unless you can, with some semblance of veracity, recall fondly your first office in the old ICC building at 17th and Pennsylvania, or the in-house parties that Sumner Pike used to throw, or how you drafted Rule 10b-5, or working on the famous Note to Form E from which grew, more or less, Rule 133.

The Classical Period pretty clearly extended into the move to Philadelphia -- at least the early days there, and you can qualify for a junior membership by remembering your office at the Penn A.C., and strolling by Rittenhouse Square to the Carlyle to hoist a few on some utility lawyer's expense account -- at least until Life magazine sent a photographer into the barroom -- where, incidentally they got a

shot of my father getting ready to pick up a tab -- but only the back of his head, he was happy to learn.

Those good old days count, not as much as 17th and Pennsylvania, but enough. It seems safe to say that the Classical Period did not extend beyond the Philadelphia captivity, although participating in the trek back to the land of Goshen was worth many points when I first arrived in the early fifties. The tarpaper shack on Second Street is a romantic place in my memory, but it clearly isn't Classical -- Middle Period, perhaps -- if only because the people who worked there have never been any match in conversational combat for 17th and Pennsylvania and Penn A.C. types.

So, at such gatherings, I am always one-upped, and I have long since accepted my utter inability to crash the upper ranks. For a brief moment during cocktails, I thought I might at least be winning the race for the most speeches in the first seven months in office, but the consensus favored Manny Cohen. Dick Phillips, who used to work on Manny's speeches, was even more certain that Manny is far ahead in number of drafts of speeches. Harvey Pitt and Kathie McGrath, who work on mine, will be happy to know that we must try harder.

During the discussion period -- before the affair settled down to booze and the telling of lies -- persons present took turns commenting on the Commission. There were, as one might expect, along with the reminiscing, echos of old battles, demonstrating once more that the oft-noted stubbornness of facts is as nothing compared with the stubbornness of ideas, and most especially of positions once taken and manfully pressed and defended on securities law matters.

But this was not all. There were strong assertions that the SEC must somehow do better in the prevention of fraud. One person pressed the pervasiveness of fear and suspicion among ordinary citizens and small investors away from major financial centers that there is too much fraud and wrongdoing by people in high places in our business life, asserting further that this is an important factor in keeping individuals out of our stock markets. I have no quarrel with such propositions, but I was a little surprised at the dominance of this theme on that occasion.

There were other observations -- not all of them complimentary. We received orally a fairly critical deficiency letter suggesting some more detailed departures from perfection, but I don't think I will expand the exposure of uncomplimentary remarks by putting them in my speech. I think our critics should have to make their own speeches.

My remarks last night were devoted to two general matters, both related to the present state of the SEC. First, I talked about the state of our budget and personnel, then about our evolving sense of involvement with our capital markets. Inasmuch as the remainder of this conference will be devoted to discussions of more technical matters by SEC persons who are more intimately familiar with their particular areas than I, and inasmuch as an SEC practitioner must perforce have some involvement with the SEC and hence some interest in its internal, as well as external, affairs, I propose this evening to speak on these themes of Commission conditions and mission.

As for the Commission itself, I presume you know that the '34 Act, which created the Commission, provides for five Commissioners serving five-year terms, one of which expires

each June 5th. Commissioners are appointed by the President, subject to confirmation by the Senate, and the Chairman is designated by the President from among the Commissioners. The designation of the Chairman is not subject to confirmation by the Senate, although there is a bill pending in Congress that would make it so, and the Chairman presumably serves as Chairman, although not as Commissioner, at the pleasure of the President. No more than three Commissioners may be members of the same political party.

While the '34 Act is silent on the subject, it is well-settled that the Commission acts formally by majority vote and, for this purpose, the Chairman has one vote like anyone else. The Chairman does have certain administrative responsibilities and authority not shared with the other Commissioners, but on the adoption of rules and orders and most other matters with which you are likely to be concerned, we act as a body with majority rule.

Unless, of course, we have delegated authority to a staff officer. Originally, all formal acts of the Commission had to be taken by the Commissioners themselves -- including all accelerations, grants of extension of time to file and the like. Since 1962, I am happy to say, the Commission has had authority to delegate certain of its duties to the staff in the first instance, and you will find the details of our exercise of that authority in the Code of Federal Regulations, 17 CFR § 200.30 et seq. If you are handling business with the Commission, you should be familiar with this delegation because you ought to know where your decisions will be made.

The Commission can, of course, and does review actions taken by the staff officers pursuant to delegated authority, conceivably on its own motion but usually on request by the affected party. By law, certain actions by the staff, pursuant to delegated authority, are reviewable by the Commission as a matter of right. As to other staff actions, Commission review is a matter of grace. A request for review is always brought to our attention, whether made directly to us or to the staff, but we do not always grant it.

This process has become somewhat complicated by the decision of the Court of Appeals for the D.C. Circuit in the Medical Committee case, subsequently vacated as moot by the Supreme Court 1/ and the very recent decision of the Court of Appeals for the D.C. Circuit in Kixmiller v. Securities and Exchange Commission 2/. We are now getting requests for review tha are obviously drafted with a view to providing a foundation for court review under the Medical Committee decision. This is producing a sort of certiorari process in which we first look at such a matter only enough to decide whether we want to get into it. As one commentator observed, we peek under the covers to see whether we want to jump into bed. If we decide we do not, the Kixmiller decision says there is no court review. The matter is not entirely clear or satisfying, but I should not pursue this digression.

We now have all five Commissioners on duty, for which we are grateful, but what about the staff? Its size is

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1/ Medical Committee for Human Rights v. Securities and Exchange Commission, 432 F. 2d 659 (D.C. Cir. 1970), vacated as moot, 404 U.S. 403 (1972).

2/ [Current] CCH Fed. Sec. L. Rep. §94,378, at 95,303 (D.C. Cir. Jan. 30, 1974).

largely a function of budget, which is ultimately determined by Congress. Its composition is determined by us within the rules of Civil Service and the authority of the Civil Service Commission.

For some years now the Commission has operated under what it has felt to be rather severe budgeting constraints and, during some periods, prolonged uncertainty. Ideally, our budget is set by the beginning of our fiscal year, which, of course, is July 1, so that we begin the year knowing how much we have to spend. Some years, however, for one reason or another, Congress has not acted by July 1, and the Commission has had to operate well into the fiscal year without knowing with any certainty what funds will be available. As you can imagine, this can make fall recruiting of college and law school graduates difficult. We cannot make promises.

Incidentally, I should say something about all of the money we collect. Congress has pushed the Commission toward becoming more nearly self-sustaining through fee collection, and this accounts not only for the sharp increase in the size of fees but the imposition of fees on many filings that used to be free. During fiscal year 1973, our revenues from fees were about $22.1 million, or 73% of our budget of $30.3 million. While this helps us in our budget requests, we do not get to

keep these fees. They all go into the General Fund of the Treasury, and we can spend only what is appropriated for our budget.

For the present fiscal year, we are operating on a pleasantly increased budget of approximately $34 million. This enables us to hire a total of 263 additional staff members, of whom 100 will be professional persons including 65 lawyers. Because our budget was settled early enough last fall, we were able to recruit and make commitments to 13 law students with excellent records and promise. We are hopeful for a good increase for fiscal '75.

When we have filled all of the places made available by our present budget, we will have a total of about 1,919 persons of whom 1,227 will be in our Washington headquarters and 692 in the several regional offices; 1,219 will be professional and 700 clerical and administrative; 590 will be lawyers. This will be the largest our staff has ever been. The next highest number was 1,683 in 1941.

How is our force deployed among our primary programs? Twenty-five percent in market and broker-dealer regulations; 27% in disclosure; 34% in fraud prevention; 2% in utility

company regulation; and 13% in investment company and adviser regulation.

I think you can easily imagine our problems in personnel deployment. Some of our activities are fairly predictable, such as routine inspection programs and processing of '34 Act filings. Some are not, notably '33 Act registrations. Currently these are down, as all of you know. I would like to look forward to being flooded with them any day now, but our reading of the tea leaves is no better than yours -- maybe worse, since you are closer to the source.

Like any going organization, hiring and retention of qualified personnel are perennial matters of concern. SEC personnel are like anyone else -- they are attracted to the Commission and stay with it according to whether the totality of compensation, job satisfaction and prospects for the future meet their needs, within their abilities and opportunities. Given adequate and timely budget determinations, we seem generally to be able to compete successfully in recruiting youngsters. The problem is keeping them.

Government pay, as you may know, is fixed according to Civil Service grade and longevity, or "steps" within the grade. A person is promoted by being advanced to a higher grade. Because we don't go around with our rank on our

shoulders or our sleeves, and there is no saluting, Civil Service grades are not quite so important as military grades, but almost. Civil servants are very conscious of one another's grades, and it frequently surprises me how little aware practitioners, especially those who have never been with the government, are of this aspect of life among the staff.

It is our job to assign appropriate grades to specific jobs and to justify these grade allocations to the Civil Service Commission. Naturally our tendency is to up-grade jobs to enable us to promote people. The Civil Service Commission's job is to resist this tendency to the extent that it may get out of line with other agencies and offices of the government. The so-called supergrades, GS-16, 17 and 18, are in particularly short supply, there being an overall government-wide limitation on the number of these. At the moment, we have several persons who are in jobs which have been approved for GS-16, but they are still 15's because we have used up our 16's. We are trying to get more.

As for pay, the numbers change absolutely, but not much relatively. For years, for example, we have been able to offer graduating law students a beginning salary somewhat below the going rate for top law firms, but close enough to be competitive, all things considered. We can start lawyers now

in GS-11, at just under $15,000. In three to four years they should be GS-13's at $20,677. This is quite satisfactory and we have good success at keeping lawyers for three years. From then on, the discrepancy between government compensation and what a more successful lawyer can make in private practice begins to widen. Getting above GS-13 takes time or exceptional ability or good luck, and even at GS-14 the base salary is only $24,247.

For this and no doubt other reasons the average service of our lawyers over recent years has been 3 years and 11 months. I hear complaints from time to time from older practitioners that their matters are being handled by staff attorneys who are so young and inexperienced. Well, this is a major reason. In one of our regional offices, the senior investigative attorney has been out of school less than 3 years. These young fellows are the bulk of our professional staff and they do a great job within their experience and ability, but we cannot inject them all with instant maturity and wisdom.

Of course, the whole system depends upon enough professional people staying on long enough to fill the supervisory ranks with more experienced persons. With the degree of raiding falling off currently, we look forward to retaining some exceptionally good career people from the present crop.

I mentioned that '33 Act filings are down, but enforcement activity is up, and so in a very different vein, is the time and attention we are spending on legislative matters. Never in the Commission's history have there been so many bills pending in the Congress which affect our securities laws and on which our views are sought. There are almost 30 different such bills now in various stages of introduction, hearings and markup. Much of this legislation stems from the studies of our securities markets made for subcommittees chaired by Senator Williams and Congressman Moss. The proposed legislation of this sort will, if enacted, have a comprehensive effect on our securities markets and our authority and responsibility with respect to them. Altogether these proposals cover some 227 pages of proposed statutory text, and the job of analyzing, commenting and testifying on all this has been formidable.

Other pending bills include such topics as the regulation of oil and gas investment programs, permitting commercial banks to underwrite municipal revenue bonds, regulation of the municipal securities industry generally, requiring disclosure of portfolios and transactions by

institutional investors, providing for a study of foreign investment, and limiting foreign investment in American companies. All of these require analysis and the development and presentation of our views.

Some of the proposed legislation would involve the Commission in all or part of the capital markets in a manner and to a degree that is new. It is not, however, primarily legislation that I had in mind in my earlier reference to our evolving involvement. This evolution has been going on and will continue unless deflected by unforeseen legal or other forces.

For over ten years now, beginning with the Special Study, the Commission has been engaged in a series of critical examinations of the behavior and structure of our capital markets. After the comprehensive review of virtually every aspect of the markets in the Special Study, there followed the study on Public Policy Implications of Investment Company Growth (which had been preceded by the so-called "Wharton School Study", which was contracted out), the Institutional Investor Study, the Study of Unsafe and Unsound Practices of Broker-Dealers, the House and Senate subcommittee Securities Industry Studies, and

prolonged sets of public hearings on stock exchange commission rates. To these may be added, I suppose, the lengthy negotiations leading to the opening of the Chicago Board Options Exchange on a pilot basis and the hearings just concluded in that area. The past decade has been one of virtually continuous examination through formal studies and hearings of almost every aspect of our capital markets -- every aspect except what currently seems like the most important one, namely, why did stock prices fly so high and sink so low and when will they rise again? On this latter subject, the Commission has consistently disclaimed jurisdiction.

Out of all this, the Commission has developed a plan or program for the structure of a new united market system for the future. We think the vision is fairly clear; it is largely shared by the legislation sponsored by Senator Williams and Congressman Moss, was recently endorsed by Professor Lorie in his statement to Secretary of the Treasury Schultz, and is accepted by an increasing number of responsible persons in the industry and its self-regulatory bodies. It should be an exciting prospect, seeking, as it does, to exploit as effectively as possible the benefits of competition and modern technology to develop more

efficient and fair markets for our more actively traded common stocks. Our capital markets are a precious national asset and one of the wonders of the free world, and the program espoused by the Commission -- though not invented by it -- promises to make those markets even better.

In this long process, however, the Commission appears to have assumed a new role in relation to our market system. Instead of being content to police a system developed and operated by the private sector, the Commission has undertaken a leading role in developing a new system. We have gone beyond criticism of specific aspects of a private system, where deemed necessary to ensure fairness and to protect small investors, to presuming to lay down a whole new pattern for the future. Of course, the ideas involved were not necessarily first conceived by the Commission, nor can the Commission do the job alone or by sheer force of law. The intelligent participation and cooperation by the industry and its self-regulatory bodies is obviously essential for the preservation of free capital markets.

With this new assertion of authority must come responsibility, and it comes at a hard time. The whole process might have been fun, had the markets stayed up in price and

volume and all the members of the industry stayed healthy. That's the way it was when it all began. That's not the way it is today. The securities industry is not in good condition, and we are faced with the task of trying by every means within our power or influence to restore it to health while guiding and pushing it into the new world. Sometimes our resources seem lamentably feeble for the task. We cannot order the market to improve. We cannot order people to keep their capital in the industry or to stay in business. Still less can we order new people to put new capital in. Nevertheless we must do what we can, and encourage others, both governmental and private, to work toward this end.

Why, and what of it, as far as you as practitioners are concerned? In crassest terms, because there isn't much pleasure or profit in a securities practice without securities and transactions in securities. The more there are of each, the more pleasure and the more profit. In more basic terms, because the process of capital formation in a free economy absolutely depends upon underwriting and distribution capacity that is free, efficient and competitive and adequate to the demands of industry. And the demand for new capital, especially equity

capital, for the next five and ten years will be enormous by any standard -- easily running in the aggregate to trillions of dollars. We must have the capacity to provide this capital through our present market system or suffer the economic and social consequence of failure.

This is no time to go further into what we might do, even if I were clear in my own mind. My purpose is to urge you to look on this matter as citizens and lawyers and securities practitioners with understanding and concern. I am alarmed at the degree of callousness being displayed to the troubles of others in these troublesome days. Latent resentments and hostilities are being paraded in foolish and short-sighted disregard of the magnitude of our problems and our common interest. The current plight of our securities industry needs all the sympathetic attention it can get through helpful legislation and otherwise, and I hope you will lend your support.