United States Senate

COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
WASHINGTON, D.C. 20510

July 1, 1976

The Honorable Roderick M. Hills
Securities and Exchange Commission
500 North Capitol Street
Washington, D. C. 20549

Dear Mr. Chairman:

Aspects of your testimony earlier this week before the Commerce, Consumer and Monetary Affairs Subcommittee of the House Committee on Government Operations are of such deep concern to me that I feel compelled to communicate them to you directly. The subject of those hearings--the activities of foreign investors in the United States securities markets, the need to improve our ability to monitor inward investment flows through additional disclosure and the desirability of remedial enforcement legislation--are matters of immediate interest to me in the context of pending legislation.

Specifically, I am concerned that the Commission's support for such legislation is oscillating. In addition, I am fearful that your recent testimony conflicts with statements and representations made by former Chairman Garrett and yourself to the Subcommittee on Securities during the consideration of S. 425, S. 953, and S. 3084--and finally--that you do not appreciate fully the reasons for purposeful Congressional action last year to restrict the Commission's ability to proceed administratively against "any person", regardless of whether they are registered broker-dealers, associated persons or otherwise connected in any respect with the activities of such a registrant.

The deficiencies of present data-gathering capabilities concerning foreign investment in the United States led to the introduction on January 27, 1975, by Senators Sparkman, Jackson, Thurmond, Laxalt, Weicker, Leahy, Morgan, Tunney, Brooke and me, of S. 425, the Foreign Investment Act of 1975. As introduced, this bill would have amended the Securities Exchange Act of 1934 to expand existing section 13(d) reporting requirements, establish a system to identify beneficial owners of an issuer's securities, and supplement the Commission's authority to enforce the proposed disclosure and reporting requirements against foreign investors.

At the time of its introduction, the Commission took the position that full disclosure under the securities laws could adversely affect the Administration's policy of encouraging foreign investment in the United States. The final version of the bill, however, approved by the Senate Committee on Banking, Housing and Urban Affairs and now pending before the Senate (S. 3084), mirrors many of the provisions which you initiated as a compromise in an undated letter to me and which you endorsed in a subsequent letter dated December 12, 1975, notwithstanding the Administration's continuing opposition. While this legislation represents a balanced approach to fill serious informational deficiencies in the Commission's disclosure program, I for one, would still support full and complete disclosure as envisioned in the original bill.

Having worked so closely with the Commission in the development of this bill, I am at a loss to explain certain aspects of your statements before the House Committee. For example, nowhere in your statement can I find any reference to the reporting and disclosure requirements which Title III of S. 3084 would add to the laws you administer or your support for these provisions. Compounding my concern is the emphasis given in your testimony to pending rule changes which the Commission first proposed in August 1975 and your statement that "the Commission and the Congress should consider the operations of new (Commission) rules before recommending any additional legislation" in the area of disclosure of beneficial ownership. It should be noted that the Commission first began its consideration of this matter in 1974 and as of this date, no affirmative action has been taken.

Thus your testimony can only cause speculation as to the Commission's present position on the legislation which it was so instrumental in shaping. Given your involvement with S. 3084, testimony of this kind would be troublesome under the most ordinary circumstances; in view of the fact the Senate is scheduled to consider S. 3084 on August 5 and 6, 1976, it is more so. At the very least, I believe it would be useful for us to receive a full explanation of these apparent inconsistencies.

In addition, after reciting the difficulties encountered by the Commission in investigating securities transactions initiated from abroad, you recommended to the House Committee that additional legislation is needed to assure

effective compliance of existing and proposed disclosure requirements by foreign investors, particularly where that investor is an intermediary operating in a jurisdiction with impenetrable secrecy laws.

Not only do I concur in this assessment, but I have made numerous efforts to include such authority in S. 425. However, neither the original enforcement language of S. 425, nor subsequent revisions proved satisfactory to the Commission. Ultimately, all references to remedial enforcement authority were deleted from the bill. In its place, and again at your request, appropriate entries in the legislative history were made.

Against this background, you may appreciate how surprised I am to learn that the Commission now favors and recommends a "modest" legislative proposal to "clarify the powers of the federal courts to grant ancillary relief" in connection with Commission enforcement actions. Although you mentioned that the Banking Committee considered a similar provision last year, and suggested that reconsideration would not be appropriate, you offered no explanation of why the Committee failed to take action on this measure. I would appreciate just such an explanation of the turnabout which caused you to arrive at a position of active support for legislation which only several months ago was unsuitable to the Commission.

A final point arising from your House appearance relates to your recommendation that the Congress "restore to the Commission authority to censure foreign financial institutions engaged in securities laws violations" removed by the Securities Acts Amendments of 1975. Regrettably, the reasons for this important change in the Securities Exchange Act of 1934 may not be manifest from the legislative history. Nevertheless, the reasons are abundantly clear. In order to dispel any doubts as to the Congressional intent, it may be worthwhile to elaborate.

Prior to the enactment of Public Law 94-29, section 15(b)(7) of the Securities Exchange Act of 1934 permitted the Commission to commence administrative proceedings against "any person" to determine whether to censure or bar such a person from ever becoming associated with a broker or dealer, even in cases where the respondent had no such intention. Pursuant to this section, the Commission pursued administrative actions against persons who were not even remotely connected to a registrant subject to the Commission's jurisdiction. In

one instance (Investors Management Co., Inc., 44 SEC 670(1971)) the Commission went so far as to claim that the phrase "any person" gave it jurisdiction over respondents who were neither registered broker-dealers nor applicants for registration, arguing further that the limitation of the term "any person" to broker-dealers or individuals associated with such broker-dealers was not supported by the legislative history and prior Commission interpretations of the section.

Such a generous interpretation of its authority in 1971, and your recent recommendation to reinstate this catchall enforcement provision, may explain the increasingly vocal criticisms civil libertarians and eminent practitioners have lodged against the Commission's investigative, enforcement and adjudicatory techniques.

Whatever the merits of that debate, it is especially disappointing to hear you criticize the Congress for removing authority that was at best, overly broad and ambiguous, and at worst, susceptible to grave abuse. While there is reference in your statement to the one case in which the Commission censured a foreign bank under authority of this section, instances in which the Commission initiated proceedings against the virtually unlimited universe of persons embraced by the phrase "any person" is omitted.

Surely, persons committing securities laws violations who are not registered with or otherwise subject to the jurisdiction of the Commission over broker-dealers should not have to defend themselves in an unfamiliar, not to mention controversial, forum where they are deprived of the full range of procedural and substantive safeguards available through the judicial process. While administrative proceedings fill an important role in the SEC's program of regulation and enforcement, the Commission should recognize that they may not be appropriate in all cases, for all violations or against all persons. This is particularly true for violations of the nature referred to in your statement--manipulation, insider trading, and evasion of applicable disclosure and reporting requirements. Resort to the courts has been and should continue to be the appropriate forum for enforcement actions involving non-registrants.

The Commission's overall enforcement capability against foreign banks or other persons would not be increased or

enhanced in any appreciable way by such legislation, nor would such restoration comport with many of the procedural features incorporated into the Exchange Act by recent amendments. Even if the restoration of this power were philosophically desirable, the backlog of pending administrative proceedings, and the excessive delays such proceedings often involve and which you have criticized on occasion, would appear to militate against such a recommendation.

I share your concern that U. S. citizens may be resorting to foreign intermediaries to evade the reporting requirements of our securities laws. But I feel strongly that effective enforcement of the securities laws should not necessitate bypassing established judicial processes; rather, it lies in the continued creative, vigorous and effective use the Commission has made of the courts in the past to investigate and prosecute violations of the securities laws and in the full and complete disclosure embodied in the original version of S. 425 which the SEC, in my opinion, unwisely opposed.

With every good wish, I am

Sincerely,

Harrison A. Williams, Jr.

HAW:hmw

cc: The Honorable William Proxmire
The Honorable Benjamin Rosenthal