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THE SEC AND THE SECURITIES INDUSTRY

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Attitude

First, I would like to express my appreciation for the support I have received from so many of you. The question I most often hear is, "What can we do to help?" If there has occasionally been an adversarial attitude between the industry and the Commission, it is a thing of the past.

The industry and the Commission have an identity of interests and objectives - broad, active, efficient, fair and orderly markets and a financially and operationally strong securities industry. Each of these elements is essential to investors, the nation and the industry.

Therefore, what you can do to help is what you are doing to implement these objectives.

I will do my best to help. And having said that, I appreciate that one of the most disbelieved statements is the old saw, "I'm from the government, and I'm here to help you". Well, now that I am from the government, I am there to help.

- To help implement the foregoing objectives;
- To help peel away the excessive regulations that have accumulated over the past 50 years;
- To help facilitate, instead of inhibit, capital formation, corporate financings and efficient markets;

o And to help maintain investors' confidence in our markets through more effective disclosure, oversight and antifraud enforcement.

These are the areas I would like to discuss briefly today.

Capital Formation

Since the end of World War II, our tax, fiscal and regulatory policies have become increasingly antithetical to capital formation.

- o Mounting regulatory burdens;
- o ~~Rising inflation~~, corporate and individual taxes;
- o ~~Inadequate~~ depreciation allowances;
- o ~~Double taxation~~ of dividends;
- o ~~And one~~ of the highest effective rates of capital gains taxation in the industrialized free world;

have been emphatic disincentives to save and invest.

As a consequence, America's relative rate of capital formation among industrialized nations has plummeted, from one of the highest to among the lowest. The inevitable consequence has been a similar decline in our relative rates of productivity and growth. If the nation is to maintain its leadership in this keenly competitive global community, it is imperative that these adverse trends be reversed - now.

The Economic Recovery Act of 1981 is an excellent beginning and I have great confidence in the President's overall program - an essential element of which is regulatory reform.

Regulatory Reform

I believe industry can regulate itself better than the government can. In addition to the SIA, the SEC is working closely with the NASD, the Exchanges and other self-regulatory organizations (SROs), with a view to reducing its direct involvement in industry.

Net Capital Rule

For example, the net capital rule has been under review since 1978. This has been a major joint effort by the Commission and the securities industry. Ralph DeNunzio, Jack Roche and others have provided invaluable assistance in the responsible assessment of the issues.

The SEC staff has completed its analysis of the voluminous data and comments. They plan to submit their recommendations to the Commission later this month for action in January. In recognition of the industry's major advances in efficiency and risk management, the staff plans to support the SIA's recommendation that the minimum net capital requirement be reduced from 4% to 2%, computed under the alternative method, which is based on customer related receivables. This proposal will free up to $500 million of industry capital for more productive employment.

Among others, the staff's recommendations will also include:

- o Liberalization of the capital requirements for certain matched fails and institutional stock borrowings;
- o Easing the charges for 7 day short securities differences;
- o According more favorable treatment to subordinated loans.
- o And in recognition of the increased volatility of the bond markets, larger "haircuts" for debt securities.

While the public is protected up to $500,000 per account by SIPC, securities firms receive no coverage. Because of the large open positions between firms, there is greater interdependency among securities firms than in virtually any other industry. Therefore, a reduction in the net capital requirements will place greater reliance on the SROs' - that is the exchanges' and the NASD's - surveillance and early warning programs. It is, of course, in your interest to provide maximum support and full cooperation to the SROs, for they are your first line of defense.

Early detection of financial or operational problems within a firm and prompt remedial action by its management - and if need be by the SROs and the Commission - are of critical importance to the public and to the securities industry.

Market Oversight and Surveillance

Deregulation also places greater reliance on effective market oversight and surveillance by the self-regulatory organizations and antifraud enforcement by the Commission. As you know, the Commission's Market Oversight and Surveillance System (MOSS) has been criticized by the securities industry and others as costly and duplicative of the exchanges' and the NASD's market surveillance systems.

A long-time Commission concern has been an effective audit trail of securities transactions and inter-market surveillance of the stock and options markets. In August, the SROs committed to the timely implementation of effective audit trail and inter-market surveillance systems. Fulfillment of these commitments will permit the Commission to revert to an oversight role in support of the SROs. This important self-regulatory initiative is being closely monitored by Congressional committees, the press and others. It is important that it succeed in order to assure the primacy of the SROs in these areas and to maintain investors' confidence in the integrity of our securities markets.

Insider Trading Abuses

Recent articles and exposés of insider trading abuses have called into question the integrity of our securities markets. Fortune Magazine - and other responsible publications - have said, "Abuse of insider information is the rule, not the exception", and have concluded that it is so pervasive that nothing can be done about it.

They base their opinions principally on the price moves which frequently occur in the face of tender offers. However, legitimate purchases by prospective acquirors often account for price rises in the face of tender offers. Anomalous market action in such stocks also attracts legitimate purchases by speculators, professional money managers and risk arbitrageurs, who identify and closely monitor likely take-over candidates - companies selling at deep discounts from underlying asset values, low cash flow multiples and those with significant untapped borrowing capacity.

Furthermore, there are 9,000 publicly traded companies. During any given year, only a small fraction are subject to tender offers or to other extraordinary developments which offer similar certainty of significant price movements.

Over a billion dollars of securities change hands daily - and I might add - by word of mouth, in mutual trust. The prices of the vast majority of securities reflect publicly available information and investors' opinions of the prospects for the companies and the economy.

Abuse of inside information is a very serious problem, but it is the exception, not the rule. It is as wrong to overstate the problem as it is to ignore it. Few of us would play in a game in which we were told the dice were loaded against us. Public confidence in the integrity of our markets is not only justified, it is an essential element in the capital formation process.

We have by far the best securities markets the world has ever known - the broadest, the most active and efficient, and the fairest - despite those few who wantonly desecrate the public trust.

Ferreting-out such abuse is a top Commission priority. The integrity of our markets is being impugned and, in a sense, all of us are being victimized, by those few who - overcome by greed - are willing to risk their reputations and careers - prison terms, fines and civil suits - often for paltry sums. Sometimes as a favor to a friend.

Securities firms and publicly owned corporations have internal procedures and controls to deal with such problems. I can only ask that all questionable activities by your customers or employees be brought to the prompt attention of your Legal and Compliance Departments and that they continue to assist the SROs and the Commission in the eradication of this abuse. Through a joint assault by the securities industry and the Enforcement Division of the SEC, those who abuse inside information will be exposed and prosecuted.

Enforcement

The Commission's Enforcement Division has been praised by some as the best in government - and criticized by others as overzealous and heavy-handed. John Fedders, the new Director of Enforcement, intends to continue to justify the praise and to be responsive to the criticism.

Abuse of inside information, manipulation and corporate fraud are being vigorously pursued and prosecuted, within the limits of due process. Enforcement is devoting its major resources to these areas - not to inadvertent mistakes in completing forms. Effective corporate disclosure of material information can be achieved only through voluntary compliance. Therefore, consideration will be given to corporations which promptly correct erroneous or inadequate disclosures and take appropriate remedial action.

Simplification of Reporting Requirements

The Commission's rules and regulations are also being simplified in order to relieve the burdens on corporations and, at the same time, improve the effectiveness of public disclosures.

For example, in September the Commission released for public comment the "integration package", which integrates and greatly simplifies, corporate registration and reporting requirements under the 1933 and 1934 Acts and the voluminous regulations that have been issued under these acts. The integration package will telescope corporations' paperwork, time and expenses, and afford them and you

greater flexibility in structuring and timing future public offerings. And most important, these benefits will be achieved without compromising the full disclosure of material information to the investing public.

Under these new rules, debt and equity offerings for qualified issuers can be effected within a few days following the decision to proceed. In addition to relieving the paperwork blizzard, these accelerated procedures are in response to issuers' and underwriters' concerns over delays that have at times foreclosed taking advantage of changing market conditions. On the other hand, the SIA and others have raised legitimate concerns over the ability of underwriters to conduct adequate "due diligence" reviews under such tight time schedules. The SIA and other responses to the request for public comments include constructive suggestions that are being carefully reviewed by the staff.

The format of 10-Ks has also been simplified. Annual reports to shareholders can be used to satisfy some, if not all of the 10-K requirements. Also, far greater latitude and flexibility is now permitted in managements' discussions and analysis of companies' financial conditions and operating results. The objective is to encourage discussion of important financial and operational factors, rather than merely mechanical compliance - such as the recitation of percentage changes in line items.

The Commission has also recently released for public comment comprehensive exemptions for limited securities offerings. This proposal was developed in consultation with the national organization of state securities commissioners. Following adoption by the Commission, most states are expected to enact comparable exemptions -- which will be the first joint state and federal registration exemptions.

The Commission is also working with a group of state securities commissioners on the simplification and improvement of certain limited partnership disclosure documents. Hopefully, these first steps, will lead to bigger and better joint state and federal initiatives.

Investment Company Regulations

In the investment company area, over the past three years the Commission has adopted over 25 exemptive rules which cover matters ranging from investment company mergers to transactions between funds in the same complex. In general, the responsibility for judgments on such matters is being shifted from the SEC staff to the independent directors of investment companies.

A new concept under review is the unitary investment company, under which certain open-end funds would not be required to obtain shareholder votes nor even to have boards of directors. Investors dissatisfied with management's performance would simply redeem their shares.

National Market System

As you know, linkage of the Inter-market Trading System (ITS) with the enhanced National Association of Securities Dealers Automated Quotation System (NASDAQ) is scheduled to occur next March. The linkage experiment will be limited to trading in 30 stocks, both on and off the board. In addition to the specialists on the floors of the exchanges, all NASD members may make simultaneous markets in these issues.

Some are concerned that major brokerage firms may internalize execution of their order flows. Ralph DeNunzio should be applauded for his exceptional efforts to develop a public order exposure rule that is acceptable to the multiple factions within the industry. Concern has been expressed that such a rule might be extended to the over-the-counter market in general. There are major structural and other differences between auction and dealer markets. There is no plan to extend any public order exposure rule to the over-the-counter market.

Legislative Deregulatory Initiatives

In the legislative arena, the major amendments to the Foreign Corrupt Practices and Glass-Steagall Acts are of principal concern.

In testimony before the Senate Banking Committee, the Commission proposed amendments to the accounting and internal controls provisions of the Foreign Corrupt Practices Act which would ease the compliance burdens on industry. The Senate approved last week an amendment which is consistent with the Commission's testimony.

In September, Secretary of the Treasury Donald Regan, called for a national debate on the laws governing our financial institutions.

Since enactment of the Glass-Steagall Act and other depression initiatives, nearly half a century ago, webs of regulatory, tax and public policies, have been spun. At the same time, in response to changing economic conditions, particularly during the past five years, there has been a proliferation of new and innovative, financial products and services - many of which bridge traditional gaps between the securities, commercial banking, thrift and insurance industries.

They include:

Money Market Funds
Cash Management Accounts
Guaranteed Investment Contracts
Retail Repos
Variable Annuity and Life Insurance Policies

And I am sure you have more in the wings.

Legislation has been suggested to limit the competitive impact of some of these new products and services on competing financial institutions. For example, it has been suggested that money market funds be required to hold a portion of their assets in cash. The effect would be to reduce their yields.

The SEC, which has jurisdiction over these funds, has testified that such reserves are not warranted, if the purpose is to protect investors. While all investments involve risk and the quality of money market fund portfolios vary, most hold highly liquid, short-term, prime credit obligations, with an average maturity of less than 30 days. These are the types of obligations that others hold as reserves.

New and innovative products and services should be encouraged, rather than inhibited by burdensome regulations.

In addition to the new products and services, the financial service industries have also moved into each other's backyards through major acquisitions and mergers.

Regulatory conflicts and overlaps have also multiplied. Today, at least ten federal agencies* exercise jurisdiction over various aspects of our public capital markets - plus, the state banking, savings and loan, insurance and securities commissioners. Well over 100 regulatory agencies in all.

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* SEC; Fed; CFTC; Treasury; Department of Labor (ERISA); SIPC; FDIC; FSLIC; FHLBB; and the Comptroller of the Currency; plus 15 SROs (the 10 securities exchanges, NASD, MSRB, AICPA, ASB and FASB).

Our financial institutions have outgrown their suits of regulatory armor. They are bursting the seams. The time has come to simplify and rationalize the system.

Emergency relief is needed in certain quarters, such as the S&Ls and savings banks, but others require more deliberate, long-term solutions. The question posed is whether the system should - or can be - dismantled brick-by-brick or whether a more comprehensive approach should be pursued. For example, do we need over 100 governmental agencies to regulate our capital markets?

On October 30th, the Commission testified before the Senate Banking Committee on the amendments to the Glass-Steagall Act which would permit banks to underwrite municipal revenue bonds and sponsor mutual funds. Because of the multiple competing products and services offered by the banks and securities firms - and the duplicative and conflicting regulatory, tax and public policy issues involved - the Commission suggested that a nonpartisan task force of recognized authorities be formed to review thoroughly the issues and to propose a comprehensive simplification and rationalization of the system. However, in the absence of broad and effective demands by industry, Congress cannot be expected to initiate such a review.

Therefore, the Commission went on to testify that, if the banks are permitted to engage directly in broker-dealer activities, they will enjoy significant tax, regulatory and financing advantages over securities firms. We stated that competing teams should play by the same rules and with the same referees.

Therefore, the Commission supported Secretary Regan's approach - which has also been endorsed by the SIA. As you know, this approach would require the banks to set up corporate affiliates that will be subject to the same rules, regulations and tax treatment as all other broker-dealers. And conversely, broker-dealers which limit their securities activities to those authorized would be permitted to set-up banking affilitates, which would be subject to the same rules, regulations and tax treatment as all other banks.

Given a level playing field, the securities industry need not fear competition. It is probably the most entrepreneurial industry in America today. It has repeatedly demonstrated the ingenuity, foresight and acuity to anticipate and effectively fulfill the nation's financial needs.

You have in place the brilliant and highly motivated professional staffs and marketing organizations; the innovative new product development capabilities; and the massive high speed communications and data processing facilities - the clockwork mechanism - not only to discharge your existing functions with precision, but also to move fully integrated financial services into the 21st Century.

It is a golden opportunity, but you must address the issues with emphasis and conviction - now. You must accept Secretary Regan's invitation. You must join the national debate - not only over the revenue bond and mutual fund issues, but also over the much broader issue of major regulatory reform. The time - the opportunity - is now.

Conclusions

In summation, I have urged today:

- Deregulation, and a shift of greater responsibility from the government to self-regulatory organizations;
- A joint assault by the securities industry and the SEC on insider trading abuses;
- A reduction of corporate compliance burdens;
- The encouragement of new and innovative financial products and services, instead of their inhibition by burdensome regulations;
- Simplification and rationalization of the excessive, duplicative and conflicting laws that govern our financial markets and institutions;
- And your full bore participation in the public debate and sound resolution of these profound issues.

If carefully considered and effectively implemented, these efforts will enormously benefit present and future generations of investors, as well as corporations, the securities industry and the nation.

Thank you.