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SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549
(202) 272-2650

THE WORK OF THE SECURITIES AND EXCHANGE COMMISSION

Remarks by

John R. Evans
Commissioner

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The Securities and Exchange Commission is an independent regulatory agency in the executive branch of the government established by Congress in 1934 to administer the federal securities laws. These statutes were enacted to protect investors against misrepresentation, manipulation, and other fraudulent acts and practices in the purchase and sale of stocks, bonds and other securities by requiring full disclosure of certain material information so that investors may evaluate the securities being offered for sale. The federal securities laws also charge the Commission with maintaining fair, orderly and efficient securities markets in which publicly traded securities may be bought and sold.

The SEC has five Commissioners, each of whom is appointed to a five year term by the President with the advice and consent of the Senate. No more than three Commissioners may be members of the same political party. Moreover, the terms of Commissioners are staggered so that only one expires each year. This helps to maintain a certain continuity at the Commission.

One of the five Commissioners is designated by the President to serve as Chairman. The Chairman has authority to make certain administrative decisions with respect to the operation of the Commission. Most other matters are decided by a vote of all Commission members.

The Commission's staff is relatively small compared to those of other Federal government agencies. Currently, we employ less than 2,000 persons. This total includes not only our professional staff, but all of our supporting personnel as well. Approximately one third of our staff is distributed among nine regional offices, while the remainder work in the main office here in Washington, D.C.

The Commission normally holds formal meetings two or three times a week to discuss and decide those items on its agenda. Each item is usually presented for decision in the form of a written recommendation accompanied by a supporting discussion prepared by the staff. When warranted, the staff also makes an oral presentation which is often followed by an exchange of views and analysis by the individual Commissioners. This candid dialogue among Commissioners and staff members greatly enhances the Commission's decision-making process.

Pursuant to the requirements of the Government-in-the-Sunshine Act, many Commission meetings are open to the public. However, a large majority of the Commission's decision are made in non-public sessions because they involve consideration of

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matters which are encompassed within the ten general exemptive provisions of the Act. Among the matters which are frequently considered in closed meetings are those concerning the institution of investigations, the initiation and settlement of administrative or court proceedings, the granting of access to our investigatory records, and the disclosure of information which would have a substantial market impact or significantly endanger the stability of a financial institution.

In carrying out its decision-making responsibilities, the Commission is fundamentally independent of political pressures from the White House and Congress. However, we do report to our congressional oversight committees which monitor whether we are complying with our statutory mandate. Also, the Commission's budget must be approved by our oversight committees, which set an authorization limit, and the Appropriation Committees of Congress, which determine the funding limits for our activities. If we misuse our power, of course, it can be restricted or withdrawn by Congress. The federal courts are a further check on the Commission because many of our decisions are subject to court review.

As an independent, quasi-judicial regulatory agency, the Commission has enforcement, adjudicative and rule-making authority. I would like to discuss briefly some of the ways in which the Commission uses these powers to fulfill its statutory mandates.

It is the Commission's duty to investigate evidence of possible violations of the securities laws. Investigations are initiated as a result of customer complaints, newspaper articles, sophisticated surveillance of trading patterns and a variety of other sources. Nearly all of the Commission's investigations are conducted privately during which time the facts are discovered to the extent possible through informal inquiry, witness interviews, examination of brokerage records and other documents, review of trading data and similar means. Should the need arise, the Commission can authorize a formal investigation. Once this is done, the Commission is empowered to issue subpoenas requiring sworn testimony and the production of books, records, and other documents pertinent to the subject matter under investigation. If someone fails to respond to a subpoena, the Commission can seek a federal court order compelling compliance.

The facts developed by the staff during its investigation are considered by the Commission only in determining whether there is prima facie evidence of a securities law violation and, if so, whether an action should be commenced to determine whether, in fact, a violation actually occurred and, if so, whether some remedial sanction should be imposed. Assuming that the facts do establish a prima facie case, there are several courses of action which the Commission may pursue to remedy the situation.

First, the Commission may apply to an appropriate United States District Court for an order enjoining those acts or practices alleged to violate the law or Commission rules. In appropriates cases, courts have granted relief to the Commission that is ancillary to an injunction, even though such relief is not specifically authorized by the securities statutes. For instance, if the Commission obtains an injunction against a corporate officer who improperly utilized material non-public information to realize a trading profit, typically the court will not only order the officer to cease such conduct, but also to disgorge the profits which he realized from his illegal conduct.

Instead of or in addition to obtaining injunctive relief, if the misconduct is of an egregious nature the Commission often refers the matter to the Department of Justice with a recommendation for criminal prosecution of the offending person. The Justice Department, through its local United States Attorneys, who frequently are assisted by Commission attorneys, can present the evidence to a federal grand jury and seek an indictment. The ultimate decision of whether to pursue criminal prosecution rests with the Justice Department and not with the Commission.

As another enforcement tool, the Commission may, after a hearing conducted with a broad range of due process safeguards, deny, suspend or revoke the registration of those entities, such as broker-dealers and investment advisers, which must register with us to operate. In such proceedings, the Commission may also censure, suspend or bar those people who work for such operations.

Seeking remedial action against securities laws violators is only one element of the Commission's duties. For example, of equal importance, the Commission also administers the corporate disclosure system. The Securities Act of 1933 requires companies selling securities to the public to file a registration statement with the Commission setting forth financial and other information. Part of this filing, in the form of a prospectus or offering circular, is forwarded to investors so that they may evaluate the securities prior to making their investment decisions. The staff of the Division of Corporation Finance performs a selective review of these filings and notifies the registrant of possible deficiencies in disclosure which ought to be corrected.

The registration process does not insure investors against poor investment performance, nor does the Commission have authority to prohibit the sale of securities for lack of merit. The company's prospects for being profitable or the price at which securities are being offered have no bearing on the question of whether securities may be registered. The standard which must be met is that the prospectus adequately and accurately discloses the material facts concerning the company and its securities. Thus armed, the investor is expected

to make his own judgment about the merits of a particular securities investment.

In addition to the registration provisions which apply when securities are being issued to the public, companies are also required to file annual and other periodic reports with the Commission providing disclosure on a continuous basis if they have securities listed for trading on a national securities exchange or if their assets exceed $3 million and their shareholders number 500 or more. These disclosures are of the same nature as those contained in registration statements, and also are subject to a selective review by the staff. Last year the Commission implemented an integrated disclosure system designed to eliminate the overlap between registration and periodic reporting by allowing certain issuers to satisfy many registration disclosures through incorporation by reference of periodic reports. This innovation is expected to substantially reduce disclosure costs and enhance the speed with which new issues of securities can be brought to market. This streamlined continuous disclosure system enables the marketplace to evaluate securities not only when originally issued, but also on a day-to-day basis when they are being traded among members of the public.

As part of our authority to require appropriate disclosure by public companies, the Commission has broad discretionary power to establish accounting requirements for all reporting companies. However, since 1938 our position has been and continues to be that the public interest is best served by looking to the private sector for leadership in establishing and improving accounting principles and standards. The Commission, of course, retains the responsibility for overseeing the process and for assuring that the standards set by the appropriate private sector bodies are in the interest of the investing public, and that these standards are followed.

For instance, earlier this year the Commission's staff advised Aetna Life & Casualty Company that is was improperly using an accounting practice which was enabling the company to report sharply higher operating earnings. At issue was Aetna's immediate recognition of the future tax benefits resulting from current losses in its property-casualty insurance operations. However, in order to currently recognize the benefit of tax credits, existing accounting standards require that the reporting company establish beyond any reasonable doubt that it will generate enough future taxable income to utilize the tax credits within the carry forward period provided by law. The Commission was not satisfied that Aetna had met his very high standard of proof, and the company has agreed to halt this practice.

In administering the disclosure system, the Commission staff also renders administrative interpretations of the law and its accompanying regulations to help members of the public,

prospective registrants and others apply the law and regulations to particular situations. For example, this advice might include an informal opinion regarding whether the offering of a particular security is subject to the registration requirements of the law and, if so, how to comply with the disclosure requirements of the applicable registration form. The staff renders similar advice and assistance with respect to the Commission's other statutory responsibilities.

Such staff positions are often directed not only to a single registrant, but to an entire industry. For example, within the last few months the Commission's staff has taken several steps with regard to financial disclosures by bank holding companies which have substantial foreign loans. First, the staff required, among other disclosures, that such companies list all foreign countries where loans have been made in excess of 1% of the holding company's total loans outstanding. The staff believed that such information was necessary to enable investors to make their own judgments about a holding company's exposure to credit or liquidity risks as economic and political conditions change over time in various countries. Subsequently, the staff called for disclosure concerning negotiations by such countries to restructure their existing debt or to obtain additional new borrowings. Less than two weeks ago, the Commission proposed to codify these staff positions as well as establish additional disclosures to better enable investors to independently judge the impact of foreign lending risks.

The Commission's objective of effective disclosure with a minimum of burden and expense calls for a constant review of the practical operation of our rules and registration forms. If experience shows that a particular requirement fails to achieve its objective, or if a rule appears unduly burdensome in relation to the benefits resulting from the disclosure provided, the Commission will consider possible modifications. Pursuant to the requirements of the Administrative Procedure Act, the Commission normally gives advance public notice of proposed new or amended rules or registration forms to enable interested members of the public to comment on the proposals. The same procedure is followed under the other Acts administered by the Commission.

The comment process is an indispensible part of our rule-making because it provides those who are affected by our requirements an opportunity to advise us as to possible unintended and undesirable consequences of our actions. I would like to emphasize that the Commission and its staff give serious consideration to these comments and often the Commission adopts alternative approaches recommended in these comments. For example, the Commission had proposed amending its rules so that money market funds and other investment companies which attempt to maintain a stable net asset value would not have to send customers a confirmation for every automatic transaction, such

as the deposit or withdrawal of funds at predetermined times or upon the occurrence of a predetermined event. Instead, these transactions could be reported on a single monthly statement. Two weeks ago, following a broader analysis prompted by public comment, the Commission decided to permit such monthly reporting to substitute for individual confirmations for all transactions in these investment companies. Estimated annual industry savings from this change are as high as $35 million.

The final area of Commission responsibility which I would like to mention today is that of market regulation. Although the Commission has full rulemaking authority to implement its market regulatory responsibilities, often we do not fulfill these responsibilities directly because, fortunately, in my opinion, the Securities Exchange Act accords a very important role to self-regulatory organizations. The Act gives the various stock exchanges, the National Association of Securities Dealers, and the Municipal Securities Rulemaking Board certain regulatory responsibilities over those under their jurisdication. However, the Commission is required by statute to closely monitor these self regulators. The Securities Exchange Act of 1934 requires all national securities exchanges and national securities associations to register with the Commission and to adopt rules which are designed, among other things, to promote just and equitable principles to trade. The Commission is given broad powers to alter, supplement or abrogate the rules of exchanges and the NASD if such action appears to be necessary or appropriate for the protection of investors or to ensure fair dealing and trading. Rule changes which the self-regulatory organizations propose must be filed with the Commission, which in turn publishes the proposals for comment. Within a specified time period after filing, the Commission must either find that the proposed rule change is consistent with the Act and the Commission's rules and regulations thereunder, or institute proceedings to determine whether the proposed rule change should be disapproved. Thus, much of the administration of our responsibilities is carried out through consideration of self-regulatory organization rule proposals rather than by direct Commission rulemaking. Self-regulation often can be more efficient, less burdensome, and result in less government interference in the operations of private business institutions, all of which I strongly support.

However, self regulation is not always preferable to direct government regulation. For instance, recently the Commission asked for comments on a proposal to create a self regulatory organization to aid the Commission in conducting inspections of investment companies. This is a function now performed solely by the Commission. But with the rapid growth in the number of investment companies in recent years, particularly money market funds, and the prospect for even greater growth if banks are allowed into this field, some people have questioned the Commission's ability to maintain an adequate inspection cycle

in face of budgetary restraints. However, preliminary cost data indicates that turning over some inspection responsibilities to the private sector would cost substantially more than merely providing the Commission staff with more resources to do the job. It has been estimated that not only would the cost of each inspection by a self-regulator exceed the cost of a comparable inspection by Commission staff, but that the Commission would have to spend approximately $1 million annually to perform oversight functions concerning the self regulator. It was interesting to find that, when asked at a recent investment company conference, none of the 500-600 individuals present indicated that they favored a self-regulatory organization. In sum, while self-regulators perform a very important function, they by no means eliminate the need for Commission involvement.

Historically, in addition to reacting to the self-regulators, the SEC sought to fulfill the responsibilities of promoting fair and equitable markets by focusing primarily on the disclosure of material facts with respect to the nature and character of securities and on the prevention of fraud in securities transactions. In recent years, however, the Commission has facilitated a restructuring of the mechanisms and institutions through which securities are traded. This more activist Commission posture was mandated by Congress in the Securities Acts Amendments of 1975 which generally establish as a purpose of the Exchange Act the need "to remove impediments to and perfect the mechanism of a national market system for securities," and direct the Commission to "facilitate the establishment" of that system. In view of the Congressional belief that it was "best to allow maximum flexibility in working out specific details" of what should be the elements of a national market system, the 1975 Amendments neither defined the term "national market system" or mandated specified minimum components of such a system.

Although Congress was reluctant to specify the minimum components of a national market system, it did state that its general objectives include (i) the efficient execution of transactions; (ii) fair competition among broker-dealers and among markets; (iii) the availability of transaction and quotation information; (iv) the practicability of executing orders in the best market; and (v) an opportunity for orders to be executed without participation of a dealer. Personally, I have been disappointed in the rate of progress toward these objectives over the past eight years. I have also been concerned about the degree of government involvement that has been required to stimulate the changes that have occurred.

It is my view that the primary reason for both of these problems is the unwillingness of the Commission to require the removal of anti-competitive barriers to off-board trading of exchange listed securities by exchange members. Nevertheless, significant beneficial changes have occurred. The unfixing of

brokerage commission rates by the Commission in May of 1975 and the increase in market activity have brought about operating efficiencies. In addition, the Commission has enhanced opportunities for competition through various other administrative actions.

For example, with regard to all newly listed securities, in 1980 the Commission eliminated restrictions imposed by the stock exchanges which prohibited their members from trading listed securities outside of the exchange. The purpose of this action was to enable exchange members to make markets in these securities that would compete with the markets being made by the exchange specialists, and thereby enhance pricing efficiency. To facilitate this competition, last spring the Commission ordered the implementation of a linkage between the exchanges and NASDAQ, the automated quotation system used by the most active over-the-counter stocks, in order to better enable the members of each market to obtain the best price execution for their trades, regardless of which market presents that opportunity at any given time.

However, last month Merrill Lynch announced that it will stop making markets in securities that also are listed on stock exchanges because despite their ability to offer better prices in many instances, they have not been able to attract order flow, and thus have been unable to make adequate profit in their competition with the exchange specialists. Some observers believe that if Merrill Lynch, the nation's largest broker-dealer which is well known for its innovation and leadership, cannot attract order flow in competition with exchanges, the future success of such market making competition is in doubt. I believe that it is too soon to make such a judgment.

Having touched upon several areas where the Commission has primary regulatory responsibility, I would like to mention two areas where there is some confusion regarding the Commission's role.

One such topic is the Glass-Steagall Act pursuant to which Congress sought to separate the securities and banking industries primarily by prohibiting securities firms from accepting deposits and, with limited exceptions, prohibiting banks from underwriting the sale of securities. In the nearly 50 years since the enactment of this statute, the lines between these two industries have become increasingly blurred. In recent years, the accelerating convergence of these two industries and the ability of each industry to substantially circumvent its restraints has been greatly spurred by tremendous technological advances and the desire to provide innovative financial products in order to increase profits. Personally, I have views on what should be done with the Glass Steagall Act. However, I want to emphasize that the Commission has no authority to enforce the Act or to even interpret it.

I would also like to mention briefly Vice President Bush's Task Group on Regulation of Financial Services. The Commission as a body is not a member. Rather, Chairman John Shad, in his capacity as Chairman of the SEC, is a participant. This Task Group is not aimed at deciding how best to deal with existing laws and regulations such as the Glass Steagall Act, but how best to structure government regulators so that essentially similar financial services are subject to essentially similar regulation while streamlining the responsibilities of the many government agencies involved in regulating financial institutions.

I hope that I have given you a basic understanding of the role of the Securities and Exchange Commission and the way in which the Commission operates. At this time, I would be happy to try to respond to any questions you might have.