Responses by Professor David S. Ruder on July 27, 1987, to questions posed for the record by Senators Proxmire, Riegle, Sasser, Sanford, D'Amato and Heinz following the hearing on July 22, 1987 regarding Professor Ruder's nomination to be Chairman of the Securities and Exchange Commission.

I. Timing and Complexity

Set forth below are answers to 67 questions delivered to me in order to complete the hearing record in connection with my hearing before the Committee on Banking, Housing and Urban Affairs on my confirmation as Chairman of the Securities and Exchange Commission.

In view of the complexity of some of the questions and my lack of detailed information concerning some subjects, the answers will not be as complete as might be expected. My answers should be considered as subject to change based upon further information and upon discussion with Commissioners and staff of the Securities and Exchange Commission following my confirmation, if that event occurs.

II. General Statement

Taken together the questions seem to call for some general statements regarding my views. Set forth below are some responses which are general in nature and which may also be useful as reference points for answers to specific questions.

A. Regulatory View. I believe the Federal Securities Laws should be enforced with vigor. Disclosure, antifraud, industry regulation, and other provisions should be utilized by the Commission and its staff for the general purpose of protecting investors and preserving the capital markets. Although vigorous regulatory action is desirable, fairness should also be a consideration in Commission action. I do not regard myself as a "conservative," if that phrase means refraining from strong and positive regulatory initiatives.

B. Dealings with Congress. Although acting as the head of an independent regulatory agency, the Chairman of the Securities and Exchange Commission has the responsibility for interacting with the relevant appropriations and oversight committees of Congress. As Chairman, I would seek to establish a cordial and cooperative relationship with Congress, while recognizing that there inevitably will be differences in view.

C. Commission Resources. As a general and preliminary response based upon the information currently available to me, I believe the Securities and Exchange Commission needs substantial additional resources if it is to meet its increasing regulatory

obligations. My preliminary conclusion is that most of the Commission's activities would be enhanced if additional staff were available. More particularly, my observations, which may be subject to change based upon additional information, are the following:

1. The Division of Corporation Finance needs additional staff to cope with its increased review responsibility due to increases in number of filings and to the transition problems which will be associated with the implementation of EDGAR (Electronic Data Gathering, Analysis, and Retrieval).

2. The Division of Enforcement, which received staff increases during the budget year 1987 and will receive additional staff increases under the proposed budget for 1988, will need still further increases in the budget year 1989 if it is to continue its strong enforcement program in the large case area without sacrificing its capabilities in smaller cases.

3. The Division of Market Regulation needs substantial staff increases in order to increase its surveillance of self regulatory organizations, increase its direct regulation of broker-dealers, investigate and plan for developments in computerized trading, and develop regulatory initiatives for internationalization of the securities markets.

4. The Division of Investment Management needs additional staff in order to cope with a dramatic increase in the volume of investment company filings and to meet the transition problems which will be associated with the implementation of EDGAR. If regulation of investment advisers is increased, still additional resources will be required.

5. The Office of the General Counsel needs additional staff in order to become more active in important litigated cases, to meet the increasingly more complicated and numerous appellate level issues being contested by parties to Commission proceedings, to litigate the increasing number of administrative proceedings against accountants that follow from Enforcement's investigations of financial fraud, and to assist in the coordination and drafting of responses to requests by Congress and various government agencies for information, reports, legislative drafting, and testimony.

III. Responses to Senator Proxmire's Questions

Question 1. The Commission Budget Authorization Report recently issued by this Committee requested that the Commission address various issues prior to its next year's budget submission. What do you intend to do to assure that the concerns expressed therein are addressed?

Response to Question 1. I reviewed the Commission Budget Authorization Report issued by the Committee prior to my nomination hearings. The concerns raised by the Committee involve significant policy issues. If confirmed, I would, along with the other Commission members, review the issues raised to determine the most appropriate responses. My views on some of the subjects contained in that Report appear elsewhere in answers to various questions (See also General Statement C, Commission Resources).

Question 2. Your addition to the Commission makes this body possibly the most conservatively oriented Commission within the past 30 years. At the same time our markets are undergoing vast and unprecedented changes and there are numerous regulatory gaps. In recent years the Commission's efforts have been greatly directed at deregulation in the disclosure and regulatory areas. What do you intend to do to assure that the Commission is an activist regulator protecting the public and acting in the public interest?

Response to Question 2. I do not accept the characterization that my addition to the Commission would make the Commission possibly the most conservatively oriented Commission within the past 30 years. If confirmed, I would undertake to assure that the Commission continue its vigorous enforcement policies, continue to require substantial disclosures in order to protect the investing public, and otherwise act in the public interest.

Question 3. There has been concern expressed that the SEC Enforcement Division does not currently have adequate resources to fulfill its mission. In this connection, the Committee is particularly concerned that the SEC have sufficient resources to enable the Enforcement Division to fully litigate various enforcement actions in court.

Are you committed to expand the Enforcement Division to assure that it is fully able to do its work and to advise Congress of the necessity to add additional resources?

Response to Question 3. I understand that concern has been expressed about the adequacy of staff resources in the Commission's Division of Enforcement. I certainly would advise the Congress if additional resources are necessary for the Division of Enforcement to carry out an effective enforcement program (See General Statement C, Commission Resources).

Question 4. In defending his restraint on Commission resources, former Chairman Shad argued that the SEC is not the sole defense in enforcing full disclosure. He contended that false or misleading disclosures will be subjected to attack by the private bar in the form of class action suits (Wall Street Journal, 12/16/85). What is your view on the Commission shifting the burden of enforcing full disclosure to individual investors?

Response to Question 4. The Commission should not shift the burden of enforcing the disclosure statutes to individual investors. Nonetheless, it is true that private causes of action provide effective assistance to augment the Commission's enforcement efforts.

Question 5. A number of securities law practitioners, including former SEC general counsel Harvey Pitt, have noted that the practice of the Commission to define the limits of the securities laws through trial and error on a case-by-case basis suffers from a number of drawbacks. In particular, the targets of test prosecutions are victimized, the market in general operates with uncertainty as to the limits of legality, and, when the Commission does not prevail, the resulting decisions can create difficult hurdles in subsequent prosecutions. What is your view on developing the securities laws through test enforcement cases?

Response to Question 5. In my view, rulemaking is the primary method that should be employed to develop the Federal Securities Laws. Nevertheless, there are circumstances where it is appropriate and necessary to bring test enforcement cases to aid in the development of the law.

Question 6. Have you ever expressed an opinion that insider trading cases cannot be brought under section 10b-5? Do you believe that insider trading cases can and should be brought under 10b-5?

Response to Question 6. In a 1963 article entitled "Civil Liability Under Rule 10b-5: Judicial Revision of Legislative Intent?," I expressed the view that Congress did not intend to create an implied private cause of action under Rule 10b-5. Subsequently, the Supreme Court held that there is a private right of action under Section 10(b) and Rule 10b-5. I did not express the view that the Commission should not bring cases, including insider trading cases, under Section 10(b). To the contrary, I expressed the view that the Commission should bring insider trading cases. I believed then, and continue to believe, that insider trading cases can and should be brought under Rule 10b-5.

Question 7. The Commission has been criticized for being unduly influenced by the Chicago school of economic thought. That school of thought believes that the market is the best regulator, which is in substantial measure contrary to the SEC's historic mission. Recently, the Commission's economic studies have been criticized as political documents rather than thoughtful economic studies. Do you follow the Chicago school of economic thought? What will you do to assure that the Commission does not remain overly influenced by a public policy which erodes the application of the Federal Securities Laws?

Response to Question 7. Economic analysis is a useful regulatory tool. I do not place exclusive reliance on the Chicago school of economic thought, and if confirmed I would seek input from economists with various views where appropriate.

Question 8. Over the years your legal writings have reflected a rather restrictive view regarding the application of the Federal Securities Laws. Do you believe that the viewpoints reflected in these writings will impair your ability to objectively consider matters in your capacity as Chairman of the SEC?

Response to Question 8. I would not characterize my legal writings as reflecting a restrictive view regarding application of the federal securities laws. In any event I do not believe the viewpoints reflected in my writings would in any way impair my ability to be objective regarding matters that come before me in my capacity as Chairman of the Commission should I be confirmed.

Question 9. Is it your understanding that the Commission, as an independent agency is directly accountable to Congress? Are you willing to provide the Committee and the Subcommittee with such material and responses to inquiries as these Committees deem appropriate?

Response to Question 9. I have always understood that the Commission is an independent regulatory agency and I understand that Congress exercises an appropriations and an oversight function. Should I be confirmed, I would be willing to provide the Committee and the Subcommittee with materials and responses to inquiries in keeping with the agency's independence.

Question 10. The surge in well publicized instances of fraudulent activities by persons associated with savings and loans and other financial institutions raises serious questions. An enhanced governmental enforcement presence is clearly warranted. Does the SEC intend to step up its activities in this area? How will the SEC coordinate with interested bank regulatory agencies to address this serious issue?

Response to Question 10. The Commission is not the agency charged with regulating the fiscal soundness of savings and loans and other financial institutions. I understand, however, that the Commission has cooperated with the appropriate regulatory agencies with respect to current issues. If confirmed, I would continue to support this cooperative effort.

Question 11. One particularly egregious takeover practice seems to be the use of so-called "street sweeps." Street-sweeps are a method of obtaining control of a target by purchasing controlling share positions within a very short time frame without affording shareholders the protections of the Williams Act. The recent "Pay 'N Pak Stores" transaction which involved a broker-dealer

utilizing an unusual one day cash settlement practice to get shares into the hands of a corporate raider is an example. What are your suggestions for dealing with this recurring problem?

Response to Question 11. "Street sweeps" or "market sweeps" have raised concerns at the Commission. The Commission has asked for comment on ways to respond to the "market sweep" issue. I also understand that the Commission staff is preparing rule proposals for the Commission to consider within the next several weeks which would address this problem. I believe that this problem can be addressed in the rulemaking forum.

Question 12. Do you believe that the ability of individuals to bring private rights of action under the securities laws should be expanded? If so, why? If not, why not?

Response to Question 12. Yes, I believe it would be appropriate to expand the ability of private litigants to institute actions under the securities laws in certain circumstances to supplement Commission enforcement actions. However, careful analysis would be necessary to determine where additional private rights of action would be appropriate.

Question 13. The Commission has been investigating the Washington Public Power Supply System 4 and 5 bond default for over three years now. What is the status of this investigation? Do you agree this investigation has taken an overly lengthy period? Will you commit that those studies undertaken during your tenure will be completed expeditiously? When will the Commission submit a report to Congress on this default?

Response to Question 13. I do not know the status of the Commission's investigation concerning the Washington Public Power Supply System, nor do I have the information to evaluate whether the investigation has been unduly extended. Should I be confirmed, I would attempt to have the Commission conduct its inquiries in a timely fashion, taking into consideration resource allocations and enforcement priorities. I do not know when the Commission will submit the report to Congress on the bond default. I am advised by the Commission's staff that it plans to complete its report shortly.

Question 14. In its 1988 budget submission, the SEC notes that the assets under the control of registered investment advisers grew to about $1.5 trillion in 1986, amounting to about 15% of all financial assets owned by Americans. Despite the explosive growth in this industry and the magnitude of assets under its control, the SEC declined to increase the staff for this program between 1986 and 1987 and plans only a token increase in 1988. Do you believe that adequate regulatory oversight is in place for investment companies and investment advisers? What initiatives would you consider to enhance regulatory oversight in this area?

Response to Question 14. I do not have sufficient information to evaluate whether there is adequate regulatory oversight over investment companies and investment advisers. I understand that oversight is conducted by staff of the Division of Investment Management and staff in the regional offices as well. If confirmed, I will seek to determine whether there is adequate oversight in these areas and what steps can be taken to improve it (See General Statement C, Commission Resources).

Question 15. In light of recent press reports that the SEC and IRS are conducting a major investigation of billions of dollars of bond sales for projects that may not have been built, or may never be built, do you believe that the SEC should be given additional regulatory authority over the registration, disclosure and filing statements of municipal bonds?

Response to Question 15. I would favor additional regulation of the municipal bond market, contingent on two factors. First, the question of the constitutionality of the federal government requiring registration of municipal bond offerings would have to be resolved. Second, the Commission could not undertake additional responsibilities unless it were also given commensurate additional resources.

Question 16. Recently a prominent takeover lawyer was charged by the Securities and Exchange Commission with violating the disclosure rules of the securities laws.

* Do you support the Commission's bringing this case?

* Do you believe that takeover lawyers and their firms should be held accountable in certain instances, for securities law violations by their clients?

* Is there any question in your mind that if the advice a securities lawyer gives to his client is contrary to the securities laws the lawyer may be held responsible?

Response to Question 16. I do not have sufficient facts to make a judgment concerning the Commission's institution of the administrative proceeding to which the question refers. I do believe that takeover lawyers can be held accountable for securities law violations by their clients, depending on the facts and circumstances of the particular case. Additionally, if a securities lawyer deliberately gives advice to a client that he or she knows to be contrary to the securities laws, the lawyer may be held responsible.

Question 17. A number of witnesses for the securities industry have recently appeared before the Subcommittee to stress the paramount importance of maintaining the integrity and fairness of the securities markets. They point with concern to the rising apprehension of the individual investor faced with massive securities trading scandals, increasingly complex securities products, and alarming short-term market volatility. What is your response to the arguments that the individual investor is not getting a fair shake in today's marketplace, for example, that he/she is being left behind with respect to program trading, protection from insider trading, and enforcement of full disclosure?

Response to Question 17. I understand that there may be apprehension by individual investors as a result of the insider trading cases and the increasing complexity of financial products being offered to the public. Nevertheless, I believe that, for the most part, the system is working. For example, individual investors may have ready access to professional investment advice and can invest through institutional funds.

Question 18. Minority enrollment at Northwestern's law school dropped precipitously during your tenure. The year before you took control, minority enrollment accounted for 19 percent of the law school

student body. Your first year, it dropped to 14 percent. By 1980, it was down to 10 percent, and in 1984, it slipped to 9 percent. Did you make any decisions that led to this drop in minority enrollment?

Response to Question 18. No. I helped initiate Northwestern Law School's minority enrollment program in the early 1970's. The subsequent loss in minority enrollment was caused in part by competition from other law schools emulating Northwestern's example and in part by a reduction in the total number of minority applicants seeking admission to law schools.

Question 19. During the last three years, the SEC has grown impatient with the business judgment rule with respect to management defensive tactics during a hostile tender, despite the fact that the courts have upheld this long tradition. What are your views on the applicability of the rule, and what role the SEC should play in circumventing it?

Response to Question 19. The business judgment rule is not applicable if a conflict of interest exists. The Commission should urge that courts carefully consider whether management entrenchment motives in a hostile tender offer constitute a conflict of interest.

Question 20. In our tender offer reform legislation, we required greater disclosure so as to inform shareholders about the pendency of a takeover. However, we do not detail what penalties should be paid in the case of disclosure violations. What do you think those penalties should be?

Response to Question 20. There are already numerous legal consequences for failure to comply with disclosure obligations. These include civil actions for injunctive and other equitable relief; administrative proceedings to require corrective disclosure; criminal actions which provide for fines and jail terms; and private causes of action. I do agree, however, with the Commission's position, expressed in the recent testimony of Acting Chairman Cox, that monetary penalties for Section 13(d) violations would be useful in addition to existing remedies. The amount of the penalty in a particular case should depend upon the degree of culpability involved.

Question 21. At a conference of investment attorneys, I understand you participated in a debate regarding liability for corporation filings. The debate has been described as holding the outside directors to a standard of negligence or reckless disregard. You advocated the laxer standard. Could you comment on this debate, and your reasoning?

Response to Question 21. I believe that holding directors monetarily liable for negligence in corporate filings would be unwise because it would discourage people from becoming directors. My view is the same as that of Congress as set forth in Section 18(a) of the Securities Exchange Act. With respect to false documents filed under the Exchange Act, Section 18(a) provides a defense for a director who proves that "he acted in good faith and had no knowledge that such statement was false or misleading."

IV. Responses to Senator Riegle's Questions

Question 1. In the statement submitted to us, you indicate that you expect to submit your resignation as SEC Chairman in January of 1989 after the new President is inaugurated. What specific priorities have you set for yourself during the next 18 months should you be confirmed as Chairman and what kind of legacy would you hope to leave as Chairman?

Response to Question 1. I hope to leave a legacy as an active, innovative regulator who created a cooperative and efficient regulatory environment, while heeding the need to prepare for future developments and problems. My goals include the following (but not necessarily in priority order):

a. Vigorous enforcement of insider trading regulation;

b. Increased protection for broker-dealer customers;

c. Vigorous enforcement of tender offer laws and regulations in order to maintain an equitable balance between bidders and target management as a principal means of protecting shareholders of the target;

d. Continuation of a strong and effective disclosure system, including implementation of EDGAR;

e. Development of initiatives to meet program trading problems; and

f. Preparation for regulatory initiatives to meet problems associated with internationalization of the securities markets.

Question 2. As Chairman of the SEC what legislative changes, if any, would you recommend be made to the securities laws and what legislative initiatives do you think should be undertaken by the Securities Subcommittee?

Response to Question 2. At present I have not formulated my views regarding any extensive legislative initiatives. In general I would tentatively favor extending

Commission jurisdiction over securities activities of banks and over sales practices associated with the sale of municipal obligations.

Question 3. In the past the Commission, in arguing for a streamlined budget, has defended its position by saying that the self-regulatory organizations should do more in the areas of enforcement and self-regulation and pick up much of the slack resulting from the SEC's budget restraints. But isn't it a fact that the self-regulatory organizations are hamstrung by not having the legal authority to do much more than they are currently doing? What new powers, if any, do you believe should be given to the self-regulatory organizations? What do you think the self-regulatory organizations should be doing which they are not currently doing? In other words, where if at all, are they falling down in their responsibilities, and what improvements, if any, do you believe should be made in the self-regulatory process?

Response to Question 3. The self-regulatory organizations have substantial power over their members. They should be encouraged to insist that broker-dealer compliance procedures regarding relations with customers be improved. They should also insist that adequate separation exist between activities of trading departments and activities of mergers and acquisition departments. They should improve their market surveillance activities.

Question 4. A number of people have suggested to us that Congress and the Commission should prohibit "third market" trading and initiate trading halts by broker-dealers in any security when the primary market for that security has suspended trading for the purpose of facilitating dissemination of material information concerning the issuer of the security. What is your view on this subject? Isn't third market trading essentially an institutional and arbitrageur phenomenon and, in the case of a trading halt, doesn't it disadvantage the small investor?

Response to Question 4. The proposed "third market" trading halt presents complicated questions about which I need additional information. It is my understanding that the third market is an institutional and professional market, and not one in which the small investor normally trades.

Question 5. During the past year, the Committee has received numerous complaints from individual investors criticizing the current arbitration system where their claims are heard before a panel composed largely of representatives from the industry. Do you believe there is any merit to these complaints and what steps, if any, do you believe should be taken to make these arbitration proceedings fairer to the individual investor? Why shouldn't complaints be heard by an impartial non-industry oriented panel?

Response to Question 5. The system for arbitration of customer disputes with brokerage firms should be reviewed for fairness. I understand the Commission staff is conducting such a review.

Question 6. What is your view of legislation which has been introduced in the Congress on the subject of one-share/one-vote? Specifically, do you think legislation should be adopted providing that a company's shares may not be traded on a national securities exchange or through a national securities association unless each share of the company's stock has one vote?

Response to Question 6. Since the one share/one vote question is currently the subject of a Commission rulemaking proceeding, I do not believe I should comment in detail. In general I believe that removal from shareholders of the power to elect management is a dramatic change in corporate structure which should be reviewed carefully before being implemented.

Question 7. Concern has been expressed recently about market volatility, proliferation of new financial instruments, portfolio insurance and the fluctuations resulting from program trading and surrounding triple-witching hours. Many small investors increasingly feel left behind as a result of ever-more sophisticated trading techniques. To what extent, if at all, are you concerned about any of these new phenomena and, more specifically:

A. What do you see as the evolving role of the institutional as opposed to the individual investor?

B. What steps do you think should be taken, if any, to curb excessive market volatility and speculation?

C. Do you see any risk that as a result of some of these new trading techniques we might someday soon be headed toward a market meltdown?

Response to Question 7. The general subject of program trading is important and very complicated and is the subject of continuing study by the Commission staff. That study should continue. The institutional investor seems to be dominating the program trading. Excessive market speculation combined with new trading techniques may yield market volatility, but I have not yet seen convincing evidence that a "market meltdown" (presumably a program trading induced dramatic fall in market prices) is imminent.

Question 8. During his tenure as Chairman, John Shad actively restrained the resource growth at the Commission and often claimed that he was doing more with less at the SEC. However, during the budget authorization hearings for the Commission this past spring, a number of witnesses expressed serious reservation about the adequacy of the SEC's resources and raised questions about whether productivity data cited by Mr. Shad actually showed that the Commission was doing more under his growth restraints. Do you think that the SEC has been provided with sufficient resources to meet its current regulatory responsibilities? What do you anticipate your approach will be in administering the SEC's budget, particularly regarding growth at the Commission during this time of change and expansion in the securities markets?

Response to Question 8. I believe Commission resources should be increased (See General Statement C, Commission Resources).

Question 9. In its 1988 budget submission, the SEC notes that the assets under the control of registered investment advisers grew to about $1.5 trillion in 1986, amounting to about 15% of all financial assets owned by Americans. The Commission notes that this surpasses the total deposits held by banks or savings and loans and is also greater than the assets of life insurance companies. There is neither government insurance for these assets nor a self-regulatory organization in operation. The sole regulatory oversight is provided by the SEC's Investment Management Division with an annual budget of around $12

million and a staff of about 200 people. Despite the explosive growth in this industry and the magnitude of assets under its control, the SEC declined to increase staff for this program between 1986 and 1987 and plans for only a token increase in 1988. Do you believe that adequate regulatory oversight is in place for investment companies and investment advisers? What initiatives would you consider to enhance regulatory oversight in this area?

Response to Question 9. I believe the staff of the Division of Investment Management should be increased. I do not have sufficient information to evaluate whether there is adequate regulatory oversight in place over investment companies and investment advisers. Additional regulation of investment advisers and financial planners who control the assets of others would be desirable. At present I am uncertain where regulatory oversight responsibility should be located. If confirmed I will seek to determine whether there is adequate oversight and what steps can be taken to improve it (See General Statement C, Commission Resources).

Question 10. The SEC has recently operated with fee revenues exceeding its appropriated budget by over 100%. Former Chairman Shad and others often complained of the difficulty in attracting and retaining qualified professionals to the Commission due to government salary restraints which compare poorly with opportunities in the private sector. Because of the existing fee revenue structure and the chronic personnel turnover problems, it has been suggested that the Commission be converted to a self-funding status and exempted from many of the restrictions imposed on appropriated agencies. The Subcommittee has requested that the Commission prepare a study and make recommendations on a change to self-funding status. What is your view on this proposal and what alternative approaches would you propose to the staffing problems which have plagued the SEC?

Response to Question 10. A study of the possibility of self-funding would be useful. Self-funding legislation, if enacted, should include provisions assuring that Commission resources will be adequate in times of market weakness, which might result in a decrease in fee revenues, as well as in times of market strength when fee revenues are high.

Question 11. In testimony before the Securities Subcommittee earlier this year, Donald Marron, Chairman and CEO of Paine Webber Group, testified concerning insider trading abuse that, "I reluctantly conclude that Wall Street cannot solve this problem alone. The stakes are too high. The impact is too broad. It will require the joint efforts of Wall Street and Washington." As Chairman of the SEC, how would you respond to Mr. Marron's call to Washington for assistance to Wall Street on insider trading abuse?

Response to Question 11. A revived sense of integrity is needed throughout the securities markets. I would respond by making it clear that insider trading by market professionals will be dealt with harshly, including use of the Insider Trading Sanctions Act, criminal penalties, and limitations on participation in the industry.

Question 12. As you know, Senator D'Amato and I have asked a group of outstanding securities lawyers, including Harvey Pitt and John Olson, to work with the Securities Subcommittee to clarify the laws on insider trading. They submitted a proposal to us in May and the Commission will be submitting its own proposal early next month. If confirmed as Chairman of the Securities and Exchange Commission, will you work with the Congress, the Pitt-Olson group, which represents a broad array of interests, as well as with Mr. Giuliani and the SEC Division of Enforcement, to come up with insider trading legislation which the Commission will support?

Response to Question 12. If confirmed I will participate in the attempt to define insider trading, but I am uncertain whether that definition should be legislative, by rule, or by increased rulemaking power. My concerns would be that the reach of the law as it currently exists not be reduced but rather be expanded in certain respects, and, that fairness considerations be included.

Question 13. Testimony last month from the SEC on proposed insider trading legislation indicated that the Commission staff is solidly behind the misappropriation theory as a basis for pursuing impermissible insider trading. However, some of your recent comments indicate that you have an opposite view in this area. What is your opinion of the misappropriation theory, and to the extent that you do not share the historical SEC position, how would you reconcile the difference as Chairman?

Response to Question 13. The misappropriation theory has developed as a result of concurring and dissenting opinions in a United States Supreme Court case. It has been criticized because: 1) it is based upon a duty to a party not necessarily trading in the securities market; 2) it does not reach those cases in which an employer permits an employee to use non-public information; 3) it has its roots in private transactions rather than in transactions affecting the securities markets; and 4) it creates considerable uncertainty. I believe a definition can be constructed which will be more meaningfully related to the protection of investors. Nevertheless, if I were Chairman I would urge the use of the theory in enforcement activities.

Question 14. At the Subcommittee's February hearing, witnesses from the securities industry and securities law practitioners discussed several areas for possible legislative action regarding the SEC's enforcement authority. What is your opinion on the need for legislation in the following areas:

1. Cease-and-desist powers for the Commission;

2. Granting the SEC authority to impose fines as a general enforcement tool;

3. Clarifying the scope of equitable remedies that the Commission may seek in Federal district court to confirm the SEC's authority to seek a whole range of equitable remedies such as disgorgement of ill-gotten gains, the appointment of receivers, and the requirement that institutional violators of the Federal securities laws be directed to implement prophylactic measures to ensure against a repetition of the violative conduct;

4. Clarifying the SEC's disciplinary authority over broker-dealers, so that there will be no dispute concerning the agency's power to suspend errant professionals for a period exceeding twelve months but less than a lifetime bar; and,

5. Bolstering sanctions, which may currently be inadequate, for violations of the law stemming from fraudulent financial reporting, including the specific authority to bar such violators from corporate office.

Response to Question 14. My opinions regarding the need for greater Commission enforcement authority are not well formulated at this time. With regard to the specific suggestions: 1) the Commission has power to seek injunctions, and has other power under Sections 15 and 21 of the Securities Exchange Act; 2) it might not be useful to impose fines instead of imposing limitations on conduct; 3) the Commission has been quite successful in obtaining ancillary remedies as part of injunctive proceedings; 4) I am uncertain regarding the nature of the dispute concerning power to bar professionals; and 5) authority to bar those engaged in fraudulent financial reporting from corporate office may already exist.

Question 15. The SEC has made a concerted effort to regulate certain securities activities of financial institutions and has pressed for Congress to legislate "functional regulation" into place, granting to the Commission securities regulatory authority now held by Federal financial regulatory agencies. This SEC effort has taken place despite widespread questions concerning the adequacy of the Commission's resources to respond to the expanding regulatory demands of its existing jurisdiction. What is your opinion of functional regulation and what do you think the resource implications of such a change would be for the SEC?

Response to Question 15. I favor functional regulation. Increased responsibilities for the Commission would require additional resources (See General Statement, Commission Resources).

Question 16. It is widely believed that the most important function performed by the Commission's Division of Corporate Finance is the responsibility to thoroughly scrutinize and comment on disclosure materials filed with the Commission. It has been reported that in recent years the number of filings receiving full review has diminished and the level of comments has been superficial in many cases. The Form 10-K Annual Reports are the core document in the review process under the integrated disclosure system. Yet such filings, according to a recent GAO report, appear to have received low Commission priority in terms of review. The proper function of the comment and review process requires the direction and commitment of the Commission. It is important for you

to assure us that you intend to look into this aspect of the Commission's administrative processes to assure that the appropriate resources of the Division of Corporation Finance are dedicated to the review process. Will you look into this area?

Response to Question 16. Yes, of course. The staff of the Division of Corporation Finance is excellent and responsible. My understanding is that although only approximately 17% of Form 10-K Annual Reports are currently reviewed, the Division employs useful criteria in the initial screenings of filings to select those for review. I am further told that in the budget year 1988 there will be approximately 35 additional persons available in the Commission's Washington office to review filings.

Question 17. There has been some concern expressed recently that because of the abuses involving so-called insider trading cases the Commission has not devoted sufficient enforcement resources to fraudulent financial reporting cases and addressing deficient audits by accounting firms. Are you committed to assure that the Commission maintains a vigorous presence in this vitally important area?

Response to Question 17. Fraudulent financial reporting is a significant area of concern. I will hope to assure a vigorous Commission presence in this area, resources permitting (See General Statement C, Commission Resources).

Question 18. The recent National Commission on Fraudulent Financial Reporting issued an important private sector study into the causes and prevention of fraudulent financial reporting which made very specific recommendations concerning increased remedies and sanctions for the SEC as well as changes in certain SEC regulatory requirements. What do you intend to do as Chairman of the SEC to help implement these recommendations?

Response to Question 18. I have read, but have not studied in detail, the report of the National Commission on Fraudulent Financial Reporting. I will support initiatives directed toward peer review for accountants and I will seek to implement such other recommendations as I believe desirable.

Question 19. What do you see as the most pressing issues for the SEC in responding to the internationalization of the securities markets and how would you handle these issues as Chairman?

Response to Question 19. The most pressing issues regarding internationalization include disclosure problems, enforcement problems, and securities markets problems. The Commission's staff is preparing a lengthy report on these subjects and others, and the staff will be suggesting various regulatory initiatives. As Chairman I would review the report, respond to initiatives, and seek consideration of such other methods of dealing with internationalization problems as seem desirable. I understand that some dispute exists regarding whether regulation should precede or follow market developments.

Question 20. Do you think that legislation should be enacted to encourage foreign governments to enter into formal cooperative ventures with U.S. law enforcement authorities, similar to the memoranda of understanding between the U.K. and the U.S. and between Switzerland and the U.S., to ensure mutual evidentiary assistance in cases of national importance? Do you have an opinion on the suggestion that the securities exchanges should review their listing requirements with the goal of eliminating unnecessary restrictions on foreign listings? Should the Commission eliminate the short-sale rule since it does not exist on the London and Tokyo exchanges?

Response to Question 20. My current understanding is that good progress is being made regarding mutual understandings on evidentiary problems. Some relaxation of listing standards for foreign issuers might be appropriate, even though some inequities might exist between U.S. and foreign issuers. I have no current opinion on the short sale rule.

Question 21. In recent years, the Commission has greatly relaxed the disclosure standards for foreign issuers wishing to sell securities in the U.S. While we commend the opening of our markets to foreign issuers, it is critical that we not create a system that undermines investor protection or a two-tier level of disclosure. A recent "no action" letter to the College of

Retirement Equities Fund has appeared to provide a loophole whereby offerings of securities are made abroad and simultaneous distributions are permitted in the U.S. Prior to relaxing the disclosure requirements any further with respect to foreign issuers, it would appear that a complete review at the Commission level of actions in this area is warranted. Will you conduct such a review?

Response to Question 21. I will seek review of disclosure standards for foreign issuers but I am uncertain whether a "complete review at the Commission level of actions in this area is warranted."

Question 22. Several securities industry professionals have advised the Subcommittee at recent hearings that the SEC must take much more aggressive action to develop automated market surveillance systems if the Commission hopes to keep regulatory pace with expanding market volume and product complexity. Would you support new SEC initiatives to develop automated market surveillance systems?

Response to Question 22. My understanding is that the recently created Intermarket Surveillance Group will have access to good automated market surveillance systems. I will support initiatives to see that such systems are keeping pace with expanding market volume and product complexity.

Question 23. According to Saturday's Washington Post, you and your wife have held more than 50 stocks in the past year. What advice would you offer to the small investor in today's financial environment based upon your own extensive experience in the market? Do you believe that owning stock is still a good long-term investment?

Response to Question 23. The small investor should utilize professional financial management, either through a well qualified broker or through an investment fund. I believe that buying and holding a high quality stock is a good form of long term investment.

Question 24. Are you at all concerned about the amount of speculation that seems to be taking place in our domestic markets, and internationally these days and, if so, what do you think should be done about it?

Response to Question 24. Speculation is a part of the securities markets. Monitoring that speculation is part of the Commission's responsibility.

Question 25. A number of witnesses at our February hearings, including Milton Cohen, the principal author of the 1963 Special Study of the Securities Markets, suggested that this may be an appropriate time for a study to be conducted by an independent committee commissioned by, and under the jurisdiction of Congress, with a view toward comprehensive recommendations for new legislation and improved regulations. What is your opinion of such a special study and what issues do you think it should encompass?

Response to Question 25. Market changes are taking place so fast that I am uncertain whether a major study at this time would be effective. Perhaps I will be able to give a more definite answer to this question at a later date.

Question 26. The municipal securities market has grown tremendously since 1975 when Congress, in the Securities Acts Amendments of 1975, mandated registration of municipal securities dealers and the formation of the Municipal Securities Rulemaking Board. The following questions deal with the adequacy of municipal securities regulation in three specific areas: issuer disclosure, transfer agent activities, and call notification.

(A) In contrast to the corporate securities market, issuers of municipal securities are not required either to prepare disclosure documents or, if such documents are prepared, to file them with the SEC. The SEC's authority over municipal securities issuers is limited to post hoc enforcement of the antifraud provisions of the federal securities laws. During the last ten years, the SEC has been involved in three major investigations regarding the municipal securities market. In 1979, it issued a report on its investigation of transactions in securities of the City of New York. For the last four years, the SEC has been investigating the July 1983 default of $2.25 billion of the Washington Public Power Supply System ("WPPSS") Bonds, Projects 4 and 5. Recently, newspaper reports have mentioned an SEC investigation,

along with Justice Department and FBI investigations, of a number of recent municipal securities issues. Do you believe that disclosure in the municipal securities market is adequate to alert investors to the material features of these issues? In addition, do you believe that disclosures are being made available in a timely way so that investors are able to make informed decisions concerning their purchases of municipal securities? Do you have any suggestions for improvements in this area?

(B) Transfer agents that process only municipal securities and municipal issuers that perform their own transfer functions are not regulated by the SEC. Most transfer agents for corporate securities, however, must register with the SEC and are required to comply with certain performance standards with respect to their transfer activities. In addition, any registered transfer agent that also performs transfer functions for municipal securities must comply with these SEC requirements for municipal as well as corporate securities transfers. Do you believe that registered transfer agents that perform transfer functions for municipal securities issues are complying with the SEC standards? Are you aware of complaints that a number of registered, as well as unregistered, transfer agents are not transferring municipal securities in a timely fashion which increases the costs and delays settlement of municipal securities transactions? Do you believe that there should be such a regulatory discrepancy between registered and unregistered transfer agents in the processing of municipal securities? Should all municipal securities transfer agents be subject to SEC regulation?

(C) As you are aware, in December 1986, the SEC published recommended standards to improve call notification procedures in the municipal securities market. The SEC became involved with this issue when it was apprised of a number of complaints by bondholders, dealers and depositories concerning inadequate call notification. Late receipt

Question 26. Continued

by holders of call notices delays redemption of the securities and causes the loss of interest on the investment from the redemption date. In addition, bondholders who do not receive notice of partial calls may experience failed transactions, short trading positions and other clearance and settlement problems. Since the publication of the SEC notice, are you aware of improvements in the call notification process for municipal securities? Has the reaction to issuers, trustees and paying agents to this release been positive or do you believe that further action, including possible legislative action, may be needed to remedy the situation?

Response to Question 26. The municipal securities market.

A. My knowledge of selling practices in the municipal securities market is not extensive. My tentative belief is that disclosures regarding complicated municipal revenue bonds are probably not adequate. My guess is that if steps are taken to require greater disclosure at the time of initial sale there should be some distinctions made between revenue bonds and general obligation bonds. Some questions might also be raised regarding the proper role of underwriters in assuring disclosure.

B. I am unaware of complaints about transfer agents for municipal bonds and I have no opinion on this subject.

C. I have not followed the call notification problems and I have no opinion on this subject.

V. Responses to Senator Sasser's Questions

Question 1. What is your view of the role of the states versus the role of the Federal Government in the securities laws -- in other words do you favor greater Federal preemption; more authority for the States; or the status quo?

Response to Question 1. The balance of Federal-state regulation is about right. I favor Federal preemption in the tender offer area in appropriate situations.

Question 2. On December 1, 1986 the cover story of U.S. News and World Report was entitled "How the Stock Market is Rigged Against You." The story dealt in part with the Boesky scandal and the first paragraph began as follows: "Wall Street is under siege. The scandal . . . reinforces suspicions long held by individual investors: They are being cheated in a game rigged by insider traders, corporate raiders, greenmailers, arbitrageurs, 'junk bond' dealers and stock-churning brokers." I have two questions:

A. Do you believe that there is in fact something wrong going on on Wall Street and, if so, what do you think should be done about it?

B. What do you believe should be done to bolster the confidence of individual investors in the integrity of our markets?

Response to Question 2. A. Obviously there is "something wrong" on Wall Street when market professionals engage in blatant violations of the securities laws. I do not know the extent of the wrong-doing, but I favor strong enforcement activities in the market area, including strong enforcement efforts by self-regulatory organizations.

B. The case for lack of individual confidence in the integrity of our markets has not yet been made. Nevertheless, I believe that encouraging compliance with disclosure requirements and close attention to customer complaints will bolster confidence in the integrity of the markets.

Question 3. As you know, legislation to reform the Williams Act to end abuses in the tender offer process is pending before this Committee. We have heard

much testimony on this issue. I am particularly interested in Alan Greenspan's testimony yesterday concerning the debt which is accruing largely as a result of corporate takeovers. (Almost $400 billion in the last two years.) Dr. Greenspan believes that this debt will leave many companies and the economy extremely vulnerable in the next business downturn. Dr. Greenspan also indicates that many of the companies that have been subject to takeovers have been very well run. Not inefficient companies, whose management is entrenched, as some would have you believe. Now the argument that takeovers get rid of entrenched management is a primary argument in favor of takeovers. But here we have the probable next Chairman of the FED disputing this theory and pointing out serious economic fallout from the takeover trend. Do you agree with Dr. Greenspan's assessment? What actions would you take at the SEC to curb abuses in the takeover process? Will you support S. 1323, introduced by Senators Proxmire and Riegle and many of the members of the Committee, which will eliminate many of the abuses that have facilitated takeovers?

Response to Question 3. Congress adopted the Williams Act in an effort to create relatively equal conditions for the bidder and the target primarily for the purpose of protecting target shareholders. With regard to S. 1323, I am in substantial agreement with the views presented by Acting Chairman Cox on behalf of the Commission. Regarding the theory that the debt incurred in connection with takeovers will leave many companies and the economy extremely vulnerable, I do not believe the burden to prove that the debt level is injurious has been met. I do not believe tender offer legislation is the appropriate vehicle for regulating corporate debt levels in the United States, and in any event I do not believe there should be an attempt to regulate debt levels of individual companies.

Question 4. U.S. Attorney Giuliani testified before this Committee a few months ago and emphasized what he considered to be a deterioration in the ethical standards of many people working on Wall Street today. Mr. Giuliani believes that this deterioration is pervasive and may be traceable back into our educational system. I am inclined to agree with his point of view. A lot of what we have witnessed in the current insider trading scandal

is uncontrolled greed. Mr. Giuliani spoke of the need for self-policing by the securities industry, including better ethics training and oversight within the industry. He also favors improved internal auditing and control mechanisms by securities firms. Do you agree with this assessment? Do you think so-called Chinese walls actually work? What role should the SEC play in oversight of securities firms operations in this area?

Response to Question 4. My experience as a law teacher informs me that greed and lack of ethical standards will always exist. Nevertheless, I support better ethics training and oversight within the securities industry and improved internal auditing and control mechanisms by securities firms. Based upon my current information, I believe Chinese Walls can work. The Commission should encourage greater oversight of securities firms by self-regulatory organizations.

Question 5. U.S. Attorney Giuliani and others have noted to the Committee that the chances of apprehension and the possible penalties even if prosecuted for violations of the securities laws are not in balance with the enormous gains possible from these crimes. Thoughtful and informed critics have asserted that the extent of recent trading scandals may be seen as a commentary on the markets' perception of a lack of regulatory deterrence. Are the penalties stiff enough? Are there other ways we can make people pay attention to the securities laws? I note that S. 1323 raises the money penalty for violations to $1,000,000 and doubles the jail sentence to ten years -- is this sufficient?

Response to Question 5. A criminal sentence of five years is a long sentence by white collar crime standards. I believe a great deal can be accomplished by encouraging judges to impose jail sentences of longer duration. I am not sure whether larger money penalties will be successful deterrents.

Question 6. At our hearings in May on securities trading scandals, U.S. Attorney Giuliani revealed that an investigation was underway relating to possible collusion in the manipulation of securities by a group of otherwise unrelated securities industry players. The activities of investment bankers, law firms, brokers, and arbitrageurs to collusively manipulate corporate takeovers and acquisitions

has become a very real issue. What response do you believe is required from the SEC and/or Congress to this type of collusive manipulation?

Response to Question 6. The Federal Securities Laws contain ample provisions making the conduct you describe unlawful. The Commission should be vigorous in enforcing the law and seeking substantial penalties from the perpetrators of such wrongdoing.

VI. Responses to Senator Sanford's Questions

Question 1. I introduced legislation (S. 1324) on June 4, 1987 related to corporate takeovers. I would like your specific comments on certain aspects of that bill.

(a) The legislation establishes a 20% "all or none" requirement that anyone owning 20% of the shares of a corporation must purchase any additional shares by a tender offer for all remaining shares on the same terms. This provision is designed to end the so-called two-tiered or creeping tender offer that both the business groups and the capital markets group of the securities industries have stated can be abusive.

Do you think two-tiered or creeping tender offers have been abusive? Do you think any reforms are needed to curb such two-tiered offers? Please list the pros and cons that you see in the 20% all or none provision I have proposed?

(b) S. 1324 also prohibits "highly confident" letters and requires that financing be in place before a tender offer is commenced. This provision is intended to stop a manipulative tender offer where the offeror has no real intention of going forward with the tender; such offerors generally use contingent loan agreements to put a company in play without risk to themselves. The prohibition on the use of contingent funding agreements to support tender offers will require future offerors to assume some risk when they make frivolous tenders for arbitrage purposes.

What specific pros and cons do you see in the requirement that financing be in place before a tender offer is filed?

(c) In order to limit the practice where an offeror uses a target company's assets as collateral for a takeover loan facility, I have placed a requirement in my bill that for hostile takeovers of a significant

size, no more than 25% of the debt used to finance the takeover can be secured by the assets of the target. I feel that this will reduce the ability of poorly backed buyers to buy up and subsequently break up companies for short term gain purposes.

Please list the pros and cons that you see in this 25% limitation on debt collateralized by the target corporation's assets?

(d) Another provision of my bill requires that if a person makes a tender offer, or threatens to make a tender offer, then all profits (less reasonable expenses) earned by the offeror from the sale of the issuer's securities within six months of such an event would be returned to the issuer. This provision would remove the incentive that currently motivates market manipulators to make frivolous offers or threats to offer at the expense of other shareholders.

Please list the pros and cons that you see attached to this provision.

(e) I feel that our communities and the members of ESOP's have a right to know how any proposed takeover might affect them so that they may make well informed decisions as to whether they should support any particular tender offer. For this reason I have proposed that an offeror compile an economic impact statement summarizing the effects that a takeover would have on plant closings, job levels, existing collective bargaining agreements, etcetera.

Please list the advantages and disadvantages of enacting such a requirement.

(f) My bill proposes that an independant appraisal be performed before any LBO proceed to closing. It also requires a sixty day minimum waiting period between the public announcement of a leveraged buyout and closing of the same buyout. I perceive a need here for better public information to the tenderer as the inherent conflict of interest between directors/ management wanting to close an LBO and

directors/management needing to recommend a course of action to shareholders can create problems of objectivity on whether a deal is well structured from the shareholder's perspective.

Please list the pros and cons of such a requirement.

Response to Question 1. Corporate takeover legislation (S. 1324):

(a) A two-tiered tender offer is a tender offer in which the bidder usually offers cash to acquire 50% control of a corporation while simultaneously announcing that those who do not tender will receive securities in a forced merger after the first part of the transaction is complete. The two-tier offer is sometimes labelled "abusive" when the consideration to be given in the second phase is of lesser value per share than that offered in the first phase. A better term for such an offer might be "coercive," since shareholders will in a sense be coerced into accepting the first part of the offer in order to avoid receiving the lower consideration for all of their shares in the second part of the offer. Even though labelled "coercive," the better question is whether the blended price (the combination of the first stage and second stage price per share) is different than what would have been offered through a single stage "any and all" offer. My understanding is that the premiums currently offered in two-tier tender offers are not substantially different that those contained in any and all offers. It is further my understanding that the number of two-tier tender offers has been substantially reduced in the recent past. Consequently I do not think reforms are needed to curb two-tier tender offers.

The 20% "all or none" provision which you have proposed will interfere with the ability of a minority shareholder to acquire a 20 to 50% position in a company for the purpose of acquiring control through a proxy contest.

(b) In general I believe that market risks will adequately regulate loan agreements. Further, I see nothing inherently wrong in attention being drawn to the fact that a company may be a tender offer target. The result of the event will usually be beneficial to the real owners of the corporation, the shareholders, due to a rise in price for their shares. Therefore, I would not add a provision that financing be in place before a tender offer is commenced.

(c) A requirement limiting the activities of an acquiring company regarding an acquired company seems to me to be misplaced. A 25% limitation on debt collateralized by the target shareholder's assets will in effect limit the ability of the acquiring company to change the financial structure of the acquired firm. Not only will this restriction inhibit tender offers and thereby prevent shareholders from realizing greater value for their holdings, but it will amount to an arbitrary judgment regarding the amount of debt which can be carried by a corporation. Additionally, at times it may be wise to encourage the break up of a company which has mismatched divisions.

(d) The provision requiring a person making a tender or threatening to make a tender offer to return all profits made within a six month period is also apparently aimed at preventing companies from being identified as takeover targets. I see no reason why monetary gain should not be available to persons who identify undervalued companies. Nevertheless I share your concern for those who make misrepresentations about their intent, and would urge Commission action against those persons under relevant Federal Securities Laws, including Section 14(e) of the Securities Exchange Act.

(e) As I understand it, the Commission's policy over the years has been to avoid requiring disclosure of information other than that relevant to the value of a company's security. An economic impact statement falls within the category of information about which the Commission has not sought disclosure in the past. I believe such a statement would impose a cost on a bidder for the purpose of protecting interests other than those of shareholders, with the result that tender offers would be discouraged and shareholder opportunities for profits diminished.

(f) Your concern that an independent appraisal be available in leveraged buyouts is one which I share. However, I believe that state law, particularly in Delaware, makes it very likely that such an appraisal will be utilized in any event. Regarding a waiting period in a leveraged buyout there are significant restrictions on LBO activities through state and Federal proxy regulations and through Rule 13e-3 (the going private rule). An LBO in the form of a tender offer would of course be regulated by current tender offer provisions. Consequently I do not think the delay provision is necessary. If a delay were required, I would suggest the 20 business day period now utilized by the Commission in connection with tender offers.

Question 2. The recent device of so-called Bridge Financing provided by affiliates of registered broker-dealers to finance large takeovers raises various regulatory concerns for the Commission. For example, First Boston committed $1.8 billion to finance Campeau's acquisition of Allied Stores at a time when First Boston's holding company balance sheet had $1.1 billion of equity. By using its parent company and not its broker-dealer affiliate, First Boston avoided the margin rules and broker-dealer net capital rules. This type of activity appears to raise serious regulatory concerns. What steps to you intend to take to deal with this issue?

Response to Question 2. If Bridge Financing techniques of the type you describe violate either the margin regulations or broker-dealer net capital rules I would urge enforcement action.

Question 3. Recently a well-known leveraged buyout firm was reported to be raising $5 billion for future buyout activity.

I am wondering to what extent, if at all, you are concerned about so much capital being raised for this type of activity as opposed to being put to other, arguably more productive purposes?

At what point does money that is used for this purpose result in money for other purposes becoming more expensive?

Response to Question 3. My concern regarding capital being raised for acquisition activities centers on adequate disclosures being made to those from whom the capital is raised. I do not believe I have the expertise to decide which capital is being raised for productive purposes and which is not. I believe that liquidity is a vital ingredient of our capital markets, and I would have great difficulty supporting legislation which reduced liquidity by attempting to designate which uses of capital are better than others.

Question 4. At one point in his Chairmanship, John Shad expressed considerable concern about the "leveraging of corporate America." Indeed, in the last fifteen years, the average ratio of corporate long-term debt to equity has increased from 46.7 percent in 1971 to 71.4 percent in 1986.

To what extent, if at all, do you share this concern about the additional leveraging of our corporations?

Response to Question 4. The problem with concern over "leveraging" is that of identifying the "correct" level of leveraging for particular companies, particular industries, and at particular times. Leveraging may produce good profits or may cause losses, depending upon interest rates and profitability levels. In view of the inherent inability to know the long term effects of leveraging, I do not share former Chairman Shad's concerns.

VII. Responses to Senator D'Amato's Questions

Question 1. Another issue related to corporate takeovers is the proper role of the states vis-a-vis the federal securities laws in regulating corporate takeovers. This issue was somewhat complicated by the Supreme Court's decision in the CTS v. Dynamics Corp. case. Do you think the court properly decided that case and what do you think the proper role of the states should be in regulating corporate takeovers? Should the federal regulation of takeover activity preempt state regulation?

Response to Question 1. In CTS v. Dynamics Corp., the Supreme Court reached a conclusion contrary to the view expressed by the Commission. I believe the Commission's view was the correct one. To the extent that state regulation conflicts with the Federal Securities Laws, it should be preempted by the Federal law. I believe states have a legitimate role in regulating internal corporate affairs, but I do not believe states should utilize control over corporate internal affairs to inhibit a free market in securities.

Question 2. The Commission has recently instituted a rulemaking proceeding (proposed Rule 19c-4) in which it will attempt to address the issue of the one share/one vote listing standard. Without addressing the merits of that proposal:

(1) Do you believe that the Commission has the rulemaking authority to impose listing standards upon the stock exchanges and the NASD?

(2) Will the continued movement away from the one share/one vote standard have an adverse impact on the principle of shareholder democracy and further insulate managements from their shareholders?

Response to Question 2. One share/one vote listing standard:

(1) The question of Commission rulemaking authority to impose listing standards upon Stock Exchanges and the NASD is a matter of significant contention in the Rule 19c-4 hearings. I believe it best not to comment on the question.

(2) I am concerned that a permanent disenfranchisement of shareholders will have a significantly negative effect on management accountability and therefore intend to examine the 19c-4 issues with great care.

Question 3. Lost in all the publicity surrounding insider trading and corporate takeovers has been the issue of program trading. Some argue that program trading could lead to a 1929-style crash while others claim that it provides more long term stability to the market. What are your views concerning the shortcomings or benefits of program trading and what regulation, if any, is needed to prevent any manipulative use of program trading?

Response to Question 3. My present understanding is that program trading provides significant opportunity for portfolio protection and long run market stability, and that evidence of its contribution to uncorrected volatility has not yet been produced. I believe program trading should be monitored carefully.

Question 4. Some of my colleagues have been concerned about the increase in the issuance of high yield non-investment grade securities, commonly referred to as junk bonds.

A) Do these securities serve any purpose other than to finance takeovers?

B) Should limitations be placed on the amount of funds federally insured depository institutions, insurance companies and pension funds can invest in junk bonds?

Response to Question 4. High yield non-investment grade securities:

A) It is my understanding that the high yield non-investment grade debt market plays a significant and positive role in the financing of small and growing companies. These companies frequently must utilize such debt because they cannot raise equity capital and cannot secure funds from banks. This market also includes debt of companies whose investment ratings have declined from investment grade to below investment grade.

B) Limitations on the amount of high yield non-investment grade debt that can be held by certain institutions might be appropriate, but such regulation should probably not be part of the Federal Securities Laws.

Question 5. In the recent past, the members of this Committee have expressed concerns about the ability of the SEC staff to cope with its ever increasing workload. How concerned are you about the disparity between our growing markets and the SEC's relatively shrinking workforce? Are self-regulatory organizations and industry participants doing enough to police the securities markets and, if not, what more they be doing?

Response to Question 5. I believe Commission resources should be increased (See Statement C, Commission Resources). Self-regulatory organization and industry participants should increase their market surveillance capabilities, encourage separation of trading activities from merger and acquisition activities, and become more concerned with protection of customers.

Question 6. Recently, members of the Committee have received criticism that the proxy process is skewed in favor of incumbent managements and does not provide adequate information concerning the issues which shareholders must consider through the proxy process. How can the proxy process be improved and should these improvements be accomplished through amendments to existing law or through the SEC's use of its rulemaking authority?

Response to Question 6. Concerns about the adequacy of the proxy process are of long standing and have been the subject of Commission investigation on several occasions without identifying significant ways in which the proxy process can be improved. Recent voting activities of institutional investors suggest that changes in shareholder voting attitudes may be taking place which will have an effect on management concern for shareholder welfare. I believe the proxy process should continue to be monitored by the Commission.