REMARKS OF
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It is a genuine pleasure for me to talk with you today about some of the business issues that will confront us in the Second Session of Congress in 1988. As representatives of large U.S. pension funds, you are the trustees of America's economic future. Only a few months ago, on October 19, you probably realized as you never had before, what a sacred trust that is.

In my opinion, 1988 will witness the most direct intersection between Congress and business issues in the last half century.

During this current session of Congress, our Subcommittee will deal with four major issues, any one of which would have provided a full plate on the business agenda of any past Congress. Between now and November, we will address, probably through legislation:

1) tender offer reform and shareholder rights;

2) insider trading;

3) market reform and investor protection, possibly including legislation governing securities arbitration; and

4) Glass-Steagall reform and financial services restructuring.

This is a broad and, frankly, ambitious agenda. But, in my judgment, Congress must step up to the plate and deal effectively with all of these issues. Every one of them has a direct impact on the health of our economy and an equally direct effect on you and on your clients.

## FINANCIAL SERVICES INDUSTRY

Let's look first at Glass-Steagall reform. Congress should not be relegated to sitting on the sidelines while federal regulators, courts and the states dismantle, brick-by-brick, the wall that Congress erected more than 50 years ago between commercial and investment banking. If the Glass-Steagall Act needs to be changed, that change must be accomplished by Congress. To permit wholesale changes to our laws as a result of the mere "say so" of the Fed or the Comptroller is simply intolerable under our system.

Certainly it is conceivable--even likely--that the structure of our nation's financial services sector, crafted as it was 55 years ago, is in many ways outmoded. Our structure may no longer be suited to a dynamic world economy that is guided by fast-paced transactions in financial instruments that were not even dreamed of when the Glass-Steagall Act was passed. Now is the time for Congress to address systematically the changes that are needed in our regulatory and legal structure to reflect the realities of the marketplace.

I believe that Congresss is up to the challenge. The world has changed in 55 years. If the rest of the world continues to evolve financially, while U.S. laws act as a drag on the full participation of U.S. institutions in this world economy, we risk our position as a competitive force in the world today.

As a result, I think that Congress will work to develop a legislative and regulatory structure that will, while providing competitive benefits to consumers, businesses and the American economy, at the same time, secure the safety and soundness of our traditional commercial banking industry.

As I said, in past years, this one issue would be enough for the Subcommittee. But we are faced with insider trading, market reform, and corporate takeovers, as well.

## INSIDER TRADING

As far as insider trading is concerned, it is my opinion that the Subcommittee inquiry must have two prongs. The first concerns a definition of insider trading and the second concerns investor confidence in the marketplace.

It seems that everyone ranging from the New York Stock Exchange to the New York Bar Association, from Ivan Boesky's lawyer to the SEC, has tried its hand at fashioning a definition of what constitutes "insider trading." To date, a consensus choice has not emerged.

The Supreme Court did not help the matter when it reached its now-famous 4-4 tie in the Winans case.

Some believe that the very act of defining insider trading will create a roadmap that will enable market manipulators to evade prosecution. Others urge that if an offense is serious enough to be punishable by several years behind bars, it hardly seems logical that those who prescribe the punishment are incapable of describing what constitutes the offense.

Although having no definition is preferable to having a bad one, it would be most unfortunate if an impasse over this issue were to impede legislative progress with regard to insider trading generally. Hopefully, Congress and others will persevere in their efforts to develop a definition that all of us can support so that the SEC and federal prosecutors can enforce our laws governing securities fraud in a more meaningful and consistent fashion.

This is especially important because of the second prong of the Subcommittee's insider trading effort--the need to restore investor confidence.

More and more since October 19, the individual investor is fleeing the marketplace. Those who found themselves trapped in the stock market on Black Monday and Terrible Tuesday, took the first available exit opportunity. Most of these investors have not returned. Many stay away out of fear; 508 point drops in one day are more than they can handle. Other individual investors believe that the market belongs to the large firms and the institutions and that mere mortals who venture into the Land of the Giants do so at great peril. Still, other investors have come to question the basic fairness of the marketplace. Boesky, Siegel and Levine are names still fresh in their minds. Newspaper reports and the "word on the Street" daily suggest that still more indictments are to come, and that some large firms themselves may be involved. Like Balzac, the individual investor is beginning to believe that "behind every fortune there is a crime."

As a result, the individual investor doubts his ability to compete in this marketplace. We have given him cause to wonder whether the playing field is really level and whether he is the only player without inside information.

We can never forget that the individual investor is still the lifeblood of the American market. He is the force behind the institutions, the pension funds, the mutual funds. And he is daily becoming more sophisticated. If the individual investor believes that the playing field is no longer level, that the market does not provide the same opportunity it once did, he will redirect his investment funds to non-market opportunities, to the detriment of your industry and the capital formation process.

We must demonstrate to this investor the market's fundamental integrity. This includes overseeing strict enforcement measures against those who would willfully manipulate our securities markets, as well as against those who turn the other way and permit or encourage employees to engage in illegal market activities.

Congress, therefore, must keep a weather eye on developments as they occur with regard to insider trading at the Justice Department and the SEC, determine what loopholes exist in our current system, and move quickly to plug them.

## POST-CRASH LEGISLATION

The same is true with regard to market reform legislation. Last July, the Subcommittee held a full-day hearing on all aspects of program trading and portfolio insurance. I was concerned that our securities markets had become too volatile and that forces were at work in the marketplace that were not fully comprehended by the regulators or even by the users of these relatively new trading strategies.

Well, regulator after regulator, and user after user, testified that program trading and portfolio insurance posed no threat to our securities markets. The fact that neither strategy had ever been employed during a genuine bear market was of little concern.

I remained skeptical. Indeed, two weeks before the October 19 crash, I wrote to Chairman Ruder of the SEC expressing serious concern about the increased intraday and end-of-day volatility in our securities markets. When the market fell 91 points on October 6, the usual array of market analysts and technicians rushed into print to point out that, although that was the largest market drop in history, it was still only 3.4% of the Dow and that it was not a significant event.

I disagreed. In my October 7 letter to Chairman Ruder, I stated that the volatility in the Dow was becoming so great in absolute terms, that it was possible that the sheer magnitude of these numbers, coupled with the markets' ever-increasing velocity as a result of program trading, "could affect investor response and create a near free-fall situation that feeds on itself." I concluded that October 7 letter by telling Chairman Ruder, "[f]rankly, I remain unconvinced that program trading might not someday play an important role in a rapid, uncontrolled market decline."

We all know what happened less that two weeks later.

Ladies and gentlemen, our securities markets were, and still are, too volatile. In recent months, the exchanges and large market participants have appreciated the results of this volatility. Several large firms have now suspended program trading for their own accounts. Two weeks ago, the New York Stock Exchange voted to suspend program trading through its DOT system if the market moved intraday more than 50 points in either direction.

This experiment is a reasonable and responsible step, but it is aimed at a symptom rather than the cause of the problem. It controls the spread of the disease without curing it.

The decade of the 80's has witnessed a much-heralded drive for increased market efficiency. More transactions, larger block trades, executed instantly, in global markets. Obviously, in general terms, efficiency is preferable to inefficiency. However, we must keep in mind that we are not trying to create a perpetual motion machine. We are trying to develop markets that are conducive to large-scale capital formation and to design market mechanisms that facilitate investment flow. Efficiency is not the end in itself that some perceive it to be. It is a means to an end. That end is capital formation; and broad-based capital formation retreats from markets whose trading charts look like the outline of a roller coaster.

Simply put, market efficiency at the expense of market stability is counterproductive and contrary to our nation's interest. It might be more "efficient" to drive your car at 125 MPH to the store and back. You would get there twice as fast. But we made a decision that society as a whole functions better without that kind of efficiency. Now we need to make certain that the kind of "efficiency" our markets are capable of achieving works in the interest of those markets and their investors, and not against them.

It is time to recognize the unity between our futures and equity markets and treat them accordingly. We need unified regulation of stocks and stock index futures. We need equivalent margin treatment within these markets. Congress needs to take these and other steps to reduce volatility in our markets and reinvigorate investor confidence in the stability and integrity of our securities markets. As Professor Samuel Hayes has said, our markets are too important to suffer the "benign neglect" of Congress and the regulators.

But on a broader spectrum, and possibly not for immediate resolution, we need to scrutinize the rules that govern our securities markets. Are they rules that were designed to govern a marketplace for individuals, but are now stretched beyond capacity in trying to deal with a market dominated by institutions? Do we need a new set of up-to-date regulations that are better suited to govern the market as it exists today, not as it was 30 years ago?

The foundation of America's securities laws are disclosure and risk assessment. The 1933 Act and each of the subsequent securities acts followed the principle that the greater the disclosure, the more refined the risk assessment. For individual investors, disclosure is key.

But in a marketplace where large institutions hedge vast equity positions in the futures and options markets, principles governing <u>risk transfer</u>, which are not presently embodied in our securities laws, are just as important as those governing <u>risk assessment</u>. In a zero-sum game, when risk leaves one corner, it moves to another; it does not simply vanish.

As we saw on October 19 and 20, cumulative hedging of large equity positions may expose those positions to overvaluation of such magnitude that the market may not be able to absorb a return to true market price levels in an orderly fashion. This created massive market dislocation which is still working to the detriment of the capital formation process. Therefore, we need to make certain that a market that is moved by institutions is governed by modern rules designed for institutions. Otherwise, the structural safety of our markets must remain subject to question.

I look especially to you to take a leading role in addressing these issues, and to work closely with the Subcommittee in developing reforms in this area.

## TAKEOVER REFORM

Finally, there is the matter of corporate takeovers. When John Dingell and I introduced the Tender Offer Reform Act of 1987, H.R. 2172, we did so to cure the abuses that crept into the tender offer process since the passage of the Williams Act in 1968. The factual and legal landscapes have changed significantly since our introduction of that bill, but the abuses remain and should be remedied in 1988.

A few days before we introduced H.R. 2172, the Supreme Court upheld Indiana's control share acquisition statute in the CTS case. This decision was surprising. Only five years earlier, the Court had invalidated a somewhat similar Illinois statute as contrary to the Commerce Clause.

As a result of this new decision, two things happened. First, corporations took several steps backwards, away from fully embracing federal takeover legislation. They believed they were better off, and more fully protected, by legislation passed by their own state legislatures than by broader Congressional action with a national policy focus. Second, groups of investment bankers, institutional investors, so-called raiders and a few shareholder organizations urged Congress to preempt state law in this area, and prevent states from enacting new takeover statutes.

Our Subcommittee held a series of six hearings on takeover reform. Preemption proved to be a central issue during these hearings with predictable urgings coming from predictable corners.

Then another development occurred. Last month, the State of Delaware passed takeover legislation. This is of critical importance because Delaware is the legal home to approximately 180,000 corporations. Nearly half of the New York Stock Exchange-listed companies are incorporated in Delaware. As someone recently observed, Delaware is to corporate law what New Hampshire is to presidential primaries.

Briefly, the Delaware statute prevents a corporation from engaging in any business combination with any interested shareholder for three years. An interested shareholder is anyone who owns 15 percent or more of the outstanding voting stock.

This prohibition against a business combination can be overcome in several ways. The board of directors or the shareholders, by a majority vote, can decide not to be governed by the Delaware statute. If the corporation does not elect to opt out of the statute, an interested shareholder may overcome the three year restriction in three different ways: first, by gaining the prior approval of the board to the business combination or the stock acquisition; second, by acquiring at least 85 percent of the voting stock in one transaction; and third, by gaining board approval and a two-thirds vote of stockholders, not including the interested shareholder, for the business combination.

So once again the landscape has been altered, and again there is a divergence of viewpoints regarding the constitutionality of the Delaware law and the need for federal preemption in this area. The Delaware law has already been challenged in the courts and Congress is in a period of "watchful waiting" while the constitutionality issue is decided.

I would like to offer a few words of caution in this takeover debate. The strident arguments that focus only on the advisability of broad preemption of state power in the takeover area are increasingly counterproductive. Rather than galvanize positions by focusing on this most volatile and rather intractable issue, everyone who is genuinely interested in takeover reform would be better served by addressing the issues that, in all likelihood, will move this bill through our Subcommittee and Full Committee and onto the House floor. Some of the objectives we should work together to accomplish include:

(1) restrict the availability of greenmail, golden parachutes and poison pills; (2) close the ten-day window; (3) define the term "group" so as to prevent teams of market participants and raiders from tying up some of America's most productive companies and putting them "into play"; (4) assure confidential voting of proxies and greater access to corporate proxy machinery; and (5) effect other reforms that will permit productive potential takeovers to succeed, and at the same time stop the hit-and-run market manipulator in his tracks.

And, of course, I remain committed to devising a strong one-share/one vote provision; preferably one that can coexist with certain of the state control share statutes that are found by the courts to be constitutional.

Takeover reform is too important to be weighted down by buzz words such as "preemption." Federal courts will take care of state laws that cross the line of appropriate state corporate governance. Courts have already invalidated Oklahoma and Massachusetts takeover laws. And who knows what the Supreme Court will do if it reviews the Delaware law? After all, Justice Powell, the author of the CTS opinion, is gone from the Court, and Justice Kennedy may take a different view of the issue.

FOREIGN TAKEOVERS

Finally, I would add one more word about takeovers. Since the October 19 market crash, attempted foreign takeovers of U.S. companies have been on the upswing. The reasons for this are rather simple.

First, stock prices of many U.S. companies are dramatically lower today than they were only several months ago. Since, for the most part, these companies still enjoy the same asset base, productivity level and dividend stream they had before the crash, their stock prices seem to some to be at bargain basement levels.

Second, the value of the dollar has been shrinking for nearly two and one-half years. As a result, Americans pay six dollars for a cup of coffee at Tokyo's Okura Hotel, while foreign interests can purchase all of Maxwell House Corporation for the equivalent of 35 cents on the dollar.

If the dollar continues to be buffetted abroad, and stock prices remain low, or trend even lower, as some market experts predict, the increase in foreign takeovers of U.S. companies will likely persist.

Against this background, I wrote yesterday to the Chairman of the SEC to enlist the Commission's assistance in developing with Congress a national polcy with respect to foreign takeovers of U.S. companies. Some of the issues on which I sought the Commission's views included:

1) whether the U.S. government should formally review proposed takeovers by foreign entities, either by means of a takeover board or some other body such as the SEC or Federal Trade Commission;

2) whether such review should attempt to assess the substantive merits of the proposed takeover, or be limited to antitrust, financing and similar considerations;

3) whether the review would extend to all takeovers, or be limited to takeover attempts that relate to defense or national security concerns, including companies in fields such as energy and finance;

4) whether additional U.S. review of proposed foreign takeovers could disproportionately inhibit our own economic growth, or be viewed as hostile by some countries, which might then take steps to withdraw their support from our economy.

So, once again, the landscape is changing so rapidly that we need to make certain that we are not addressing yesterday's problems while tomorrow's are about to engulf us.

As we move forward on all of these issues, I ask you to stay in touch with me and with the Subcommittee. You are all on the front lines of American business. You are our early warning system. The sooner we become aware of problems, the sooner we can resolve them and help assume that our economy is healthy and that our markets are the most vibrant, honest and productive in the world today.