

**DEPARTMENTS OF COMMERCE, JUSTICE, AND
STATE, THE JUDICIARY, AND RELATED AGEN-
CIES APPROPRIATIONS FOR FISCAL YEAR
1990**

THURSDAY, APRIL 6, 1989

U.S. SENATE,
SUBCOMMITTEE OF THE COMMITTEE ON APPROPRIATIONS,
Washington, DC.

The subcommittee met at 10:35 a.m., in room S-146, the Capitol,
Hon. Ernest F. Hollings (chairman) presiding.

Present: Senators Hollings, Bumpers, Rudman, and Kasten.

SECURITIES AND EXCHANGE COMMISSION

STATEMENT OF DAVID S. RUDER, CHAIRMAN

ACCOMPANIED BY:

GEORGE G. KUNDAHL, EXECUTIVE DIRECTOR

LAWRENCE H. HAYNES, COMPTROLLER

OPENING REMARKS

Senator HOLLINGS. This morning, the subcommittee will consider the 1990 budget of the Securities and Exchange Commission. The request is for \$168,700,000, an increase of 18 percent over the current level of \$142,600,000. The increase provides for an additional 184 new positions.

Appearing on behalf of the Commission is the Chairman, David S. Ruder. Accompanying Mr. Ruder is Mr. George Kundahl, the Executive Director, and Larry Haynes, the Comptroller.

Mr. Ruder, we have your statement. It will be printed in full in the record, and you can highlight it if you wish.

Mr. RUDER. Thank you, sir. My preference is to direct your attention to the charts that are on pages 2 and 3 of the statement. Essentially, if you look at page 2 and compare 1980 to 1988 or 1980 to 1990, you will see a dramatic increase in all of the activities which are regulated by the Securities and Exchange Commission while at the same time, if you look at the staff years devoted to those activities, you will see that they are more or less equal, particularly when you compare 1980 to 1988.

Senator HOLLINGS. They are constant?

Mr. RUDER. They are constant, and if you look at the total staff years on page 3, you will see that between 1980 and 1988 the total

staff years devoted to Commission activities rose from 2,041 to 2,048, which is virtually no increase.

We have been authorized in 1989 to increase our staff years to 2,131, but because we had to absorb pay raises and other items, our actual figure, as indicated by the footnote, is something like 2,050 to 2,070.

My analysis is that in the past years the Securities and Exchange Commission has become what some of us like to call lean and mean, but that we are at a point where we have achieved all of the efficiencies that we can, and that we are now beginning to have dramatic shortages in work product.

Just by way of illustration, our ability to engage in investment advisor inspections is down to a point that we can only inspect investment advisors 1 year out of every 11. Our ability to review the financial statements of corporations in the United States is such that we continue to be unable to meet our goal of giving a full review to the financial statements of one-third of our corporate filers each year.

Senator HOLLINGS. How many years would you think is right? When you are giving us the shortfalls and the deficiencies, tell us what would be adequate, so I will have it in the record. Do you think you ought to do it every year?

Mr. RUDER. Not every year, but it is very hard to say when the time comes that the management of corporations will realize that we are not able to be regularly reviewing them. I think we ought to be assured that we can review one-third of our registrants every year. When we get past that for some registrants, we have gone too far, and we are at that now.

Senator HOLLINGS. Go ahead. Continue.

Mr. RUDER. In the broker-dealer area, where we have self-regulatory organizations, we have achieved efficiencies by asking the National Association of Securities Dealers and the New York Stock Exchange to do our broker-dealer inspections for us.

But as their inspection programs have increased in efficiencies at our urging, we are now getting more referrals from them, which increases our enforcement work, and we are not able to do as much followup examination of those broker-dealer examinations as we would like to.

Turning to enforcement, it is very difficult to quantify enforcement problems, but the increasing complexity of the litigation and the investigations that we are involved in, and the proliferation of the penny stock fraud in this country have put a dramatic squeeze on our enforcement activities. To the extent that we turn, as we will, enforcement energies to the complicated cases and the penny stock fraud cases, we necessarily reduce our coverage of the ordinary fraud matters. We simply cannot be in the position where the securities professionals or even the nonprofessionals believe that we don't have the resources to engage in adequate enforcement.

PREPARED STATEMENT

Senator HOLLINGS. Thank you, sir. We will place your prepared statement in the record at this point.

[The statement follows:]

STATEMENT OF DAVID S. RUDER

Chairman Hollings and Members of the subcommittee: The Securities and Exchange Commission is pleased to appear today to present its fiscal 1990 budget request of \$168.7 million, an increase of 18 percent over the 1989 appropriation of \$142.6 million.

The regulatory role of the SEC in the Nation's financial markets is very broad. In brief, the primary tasks of the Commission involve:

Full Disclosure.—Reviewing registration statements, annual reports, proxy statements, tender offer materials and other filings for approximately 14,000 public companies, and assisting in setting accounting standards for those companies;

Market Regulation.—Regulating the securities industry, including broker-dealers and self-regulatory organizations;

Investment Management.—Supervising investment companies and investment advisers and regulating interstate public utility holding companies;

Enforcement.—Investigating and initiating civil injunctive actions and administrative disciplinary proceedings involving securities law violations.

Since 1980 the multitude and magnitude of the tasks faced by the SEC have grown dramatically, while during the same period its staff has grown very little. Today the Commission is very efficient in its operations, but its resources are strained and it is not able to take the innovative steps necessary to oversee our Nation's securities markets in a sound manner.

A NUMERICAL VIEW OF SEC TASKS AND STAFF

The problems faced by the SEC in supervising constantly expanding securities activities are best illustrated by comparing the dramatic growth in activities the SEC regulates with the lack of growth in SEC staff size.

PRIMARY SEC ACTIVITIES

	1980	1988	1990 ¹
Full disclosure:			
1933 act new registration statements.....	710	1,671	1,700
Annual reports filed.....	8,344	11,443	12,500
Tender offer schedules filed.....	104	794	800
Staff years.....	320	399	434
Market regulation:			
Registered broker dealer firms.....	6,750	12,140	13,500
Broker dealer branch offices.....	7,370	21,480	24,000
Registered representatives.....	196,030	463,000	500,000
Staff years.....	268	214	291
Investment management:			
Registered investment companies.....	1,461	3,500	3,700
Investment co. regist. statements.....	378	1,563	1,527
Registered investment advisers.....	4,580	14,120	15,000
Staff years.....	195	213	257
Enforcement:			
Administrative proceedings opened.....	70	109	118
Civil proceedings opened.....	128	143	154
Matters under inquiry.....	2,738	1,038	1,120
Staff years.....	664	665	719

¹ For 1990 activity levels are estimated and staff levels are those contained in the SEC Fiscal 1990 Budget Estimate.

² As of 1982.

SEC STAFF YEARS

Set forth below are comparisons of SEC actual staff years levels for the entire agency for 1980 and 1988, the appropriated levels for 1989, and levels requested in the presidential budget for 1990.

	1980	1988	1989	1990
Full disclosure (Excluding electronic filing and information services)	420	399	420	434
Market regulation.....	268	244	264	231
Investment management.....	195	213	221	257
Enforcement.....	664	655	695	719
Other agency activities:				
Electronic filing.....		37	41	55
Information services.....	14	24	25	32
Public utility regulation.....	20	14	14	16
Legal services.....	146	114	121	126
Economic analysis.....	42	39	41	38
Program direction.....	240	250	269	281
Temporary positions.....	32	39	20	20
Total staff years.....	2,041	2,048	2,131	2,269

¹ In fiscal 1989, the Commission expects only to reach a figure of 2,050 to 2,070 staff years, primarily because it was required to absorb the January 1989 pay raise.

The statistical comparisons place in stark reality the fact that since 1980, Commission regulated activities have increased dramatically, while the Commission's staff has increased very little. Between 1980 and 1988, the Commission's staff grew by less than 1 percent, from 2,041 staff years to 2,048 staff years. Although the 1989 appropriated budget has a target of 2,131 staff years, the Commission presently expects to reach a figure of only 2,050 to 2,070 staff years in 1989, primarily because it has had to absorb the \$3.7 million cost of the January 1989 pay raise.

Illustrations of resource restraints on the Commission's ability to perform its functions are numerous. A few examples demonstrate the problem.

Litigation.—As you know, after 2 years of investigation the Commission filed a multi-count complaint against the brokerage firm Drexel Burnham Lambert, Inc. and against four individual defendants. We are currently involved in settlement negotiations with Drexel, but even if that settlement occurs, the Commission still faces large costs for probable litigation against individual defendants. The Drexel litigation is illustrative of the enormously complicated and expensive enforcement environment now faced by the Commission.

Market Regulation.—The October 1987 market break dramatically emphasized the Commission's role in the regulation of financial markets. Our Division of Market Regulation is so absorbed with both its normal regulatory duties and additional needs to monitor improvement of market systems, that it has not been able to establish a vitally needed capital markets unit within the Division.

International Securities Regulation.—The SEC recently has become increasingly involved in international securities regulation matters, including enforcement activities regarding cross border fraud, harmonization of disclosure and accounting standards, international capital adequacy standards, regulation of intermarket trading and clearance links, and activities of international securities regulatory organizations such as the International Organization of Securities Commissions. All of these activities create demands on staff time and travel budgets.

Public Utility Regulation.—Commission responsibilities under the Public Utility Holding Company Act of 1935 provide an important example of the imbalance between workload and resources. Three weeks ago, the CEO's of three of the largest public utility holding company systems in the United States came to my office for the purpose of asking me to assign additional staff to review filings made under the 1935 Act. They were concerned because our small Public Utility staff is unable to respond promptly to exemptive and rule making requests. I was unable to accede to their request because the staff problems they are encountering are common to every one of the Commission's functional areas.

BUDGET CONSIDERATIONS

During the period 1980 to 1988, fees generated by SEC regulated activities grew from \$49 million to \$249 million, and they are expected to increase in 1989 and 1990. The \$249 million figure should be compared with a Commission authorized budget of \$143 million in 1989 and a Presidential Budget recommendation for a Commission appropriation of \$169 million for 1990.

The Commission fully recognizes the challenges facing the Appropriations Committee in reducing the Federal deficit. At the same time, the Commission is mindful of the funding surplus generated by fees collected under the Federal securities laws.

I have testified elsewhere on the option of making the SEC self-funding. My primary objective is not to remove the agency from the budget process. Rather, it is to obtain the resources necessary to allow the Commission to exercise its statutory responsibilities successfully. For 1988 and 1989, the President proposed that the SEC be funded at \$145 million and \$160.9 million. The Congress appropriated \$135.2 million and \$142.6 million in these years. We urge Congress not to make any reduction in the \$168.7 million designated for the SEC in the President's Budget for 1990.

With me at the table today are George Kundahl, the Executive Director of the Commission, and Larry Haynes, the Comptroller. We will be pleased to answer any questions you may have.

FEES AND FINES

Senator HOLLINGS. Overall, how much are you bringing in? You know we have agencies that take in large amounts of fees. The Patent Office more than pays for itself. We learned from our hearing on the DEA drug enforcement that the seizures and sales from those seizures is more than we are paying for DEA. They are not a cost to the Government.

I think the Securities and Exchange Commission, with the stepped-up enforcement that you and your administration brought about, is more than paying for itself, or if we can really score on the *Milken* case, you might give us a surplus.

Do you have any way to measure what you are clearing? Is this the chart here? At this point, the chart entitled "SEC Fees and Fines" will be inserted in the record.

[The chart follows:]

SEC FEES AND FINES

(In thousands of dollars)

	1933 act fees	1934 act fees	Other fees	Total fees	Total appropriation	Fees in excess of appropriation	Fines ¹
1984 ...	60,124	37,206	23,652	120,982	94,000	26,982	
1985 ...	75,795	37,087	30,820	143,702	106,382	37,320	158
1986 ...	133,671	45,260	35,416	214,356	106,323	109,033	3,731
1987 ..	160,588	65,017	38,309	263,914	114,500	149,414	62,588
1988 ...	122,136	86,201	40,608	248,945	135,221	113,724	1,178
1989 ...	110,600	102,060	40,600	253,260	147,640	105,620	
1990 ...	102,660	121,900	40,000	264,560	168,707	95,853	

¹ Fines are amounts imposed under the Insider Trading Sanctions Act of 1984.

² Includes \$50 million from Bessie settlement.

FEES AND FINES

Mr. RUDER. That shows our fees, I think, from three sources: 1933 act registrations; 1934 act fees, essentially tender offer matters; and transactions on the various exchanges. We bring in, through those fees, and this is not enforcement activities, approximately \$250 million.

Senator HOLLINGS. And your budget is only, what, \$160 million?

Mr. RUDER. Well, \$142, and we are asking for \$168 million. These fees do not count the revenues that come to the Government from our enforcement activities.

Senator RUDMAN. You say it does not count those?

Mr. RUDER. That is not included in those figures.

Senator RUDMAN. It says fees and fines of \$263 million are estimated.

Mr. RUDER. Fines, yes, there are fines on the right-hand column.

Senator RUDMAN. Right.

Mr. RUDER. But the number that I look at is the total fee number, which you will see for 1989 was \$252 million.

Senator RUDMAN. All right.

Mr. RUDER. And we estimate, for 1990, fees of \$263 million.

Senator RUDMAN. What were the additional fines and so forth? Do you have that for us?

Mr. RUDER. It is over in the right-hand column. Our biggest year, 1987, was the year in which we had fines from Ivan Boesky and Dennis Levine. The number reached \$62 million. We expect, if all goes well, if settlement with Drexel occurs, that there will be \$300 million contributed in this fiscal year by Drexel to the U.S. budget.

Senator RUDMAN. That is in addition to the \$263 million, which is—

Senator HOLLINGS. In addition to \$252 million.

Senator RUDMAN. That is right.

Mr. RUDER. That is for 1989, that is right.

Senator RUDMAN. I understand.

Mr. RUDER. The U.S. attorney will take full credit and we will take full credit.

Senator RUDMAN. We have a number of reasons for asking the question. We are trying to meet our targets for this year. We are trying to see if you can help.

Senator BUMPERS. Let me go get Phil Gramm here. Let me make sure we have the troika here.

Senator HOLLINGS. If we could only give you your full request, we will make more money.

Senator RUDMAN. That is exactly right.

Senator HOLLINGS. And to cut this particular budget in the light of the enthusiasm and the conscientious job being done by Mr. Ruder and the staff over there, would be sheer stupidity.

Senator RUDMAN. We agree, Mr. Chairman.

Senator HOLLINGS. The more I give you, the more money I make. It is a wonderful deal.

Mr. RUDER. We believe that, if Drug Enforcement Administration and FBI enforcement budgets should not be decreased or should be increased, we should also be treated as an enforcement agency, which we really are, and I believe that the protection of our financial markets is of prime importance, and that is what we do.

DREXEL CASE

Senator HOLLINGS. Let's get into the costs. You mentioned, for example, the *Milken* case. How much is that going to cost us? Is that a 2-year case? You have got to guess, in some measure, I imagine, because you don't know. They might have a settlement, and there is a prosecution involved or a large bond and everything else from what I have seen in just a cursory fashion.

Can you tell the committee what is in the cards there, since you mentioned that case, about the cost of enforcement time and the man hours and so forth?

Mr. RUDER. Yes, sir; I want you to know that we are relatively cheap in terms of our cost per hour compared to the Drexel attorneys.

Senator HOLLINGS. You are the first chairman I have ever seen appear here that says he has a cheap staff. Very good.

Mr. RUDER. But we have estimated that already on the Drexel matters, which includes our case against Milken, we have expended something like \$2.6 million, and we expect to continue that investigation and we expect either to be investigating or litigating in that case for several years to come. So I have to estimate those costs in the million dollar range in the future.

Senator HOLLINGS. Yes, sir; is it that you are setting an example or will you make a recovery or both on Milken? Let's assume he were convicted just for the sake of the question. Will the Government make any recovery that you have of those resources?

Mr. RUDER. I am under very severe constraints to talk about individual cases.

Senator HOLLINGS. All right.

Mr. RUDER. I would expect that the U.S. attorney would seek financial recovery from Mr. Milken. I know that their RICO claim is in the \$1 billion plus range, so I would doubt very much that they would settle for a modest amount.

PUBLIC UTILITY HOLDING COMPANIES

Senator HOLLINGS. I see. With respect to Edgar, the automated filings, that \$5 million is now identified that we can diminish the request. We don't have to be over smart on that one.

The public utility holding companies, now, there we are dragging. We are not as assiduous, as I understand it with the public utility holding companies. Their particular petitions and filings have to await your ruling, whereas the others continue on until you tell them to stop.

In this instance, there is a tremendous backup, so much so that the public utility holding companies have allowed that they would be glad for fees to be increased to get the \$600,000 required to take care of this backlog.

Now, how do we go? We are praising you in the one breath and we are making all of this money, and then we, oh, just for \$600,000, we have a tremendous backlog? Can't you clean that up?

Mr. RUDER. Well, sir, I would like to give special attention to the public utilities, but we are squeezed in all areas. I may say I have not only had a visit from some CEO's from the public utility holding companies, but I have had David Silver from the Investment Company Institute also complaining about the lack of staff attention to exemptive requests and rulemaking in the investment management area and others.

So I have tried to allocate additional staff to the Public Utility Holding Company Act, but it just is extremely difficult to do so.

Senator HOLLINGS. Now let's make it easy; what would be required?

Mr. RUDER. Well, we think that an addition of 8 staff years would give us a very good leg-up on what we are doing.

Senator HOLLINGS. And the cost for the 8 staff years?

Mr. RUDER. It is roughly \$500,000, I think \$500 million. [Laughter.]

Senator RUDMAN. This is not the defense budget, Mr. Chairman. [Laughter.]

Senator HOLLINGS. We have already saved that \$5 million, for example, on Edgar right now. We can take that money and start allocating and step it up. You don't want to have a wonderful record there and like Bossie the cow, kick the pail over on the public utilities and just have a tremendous backlog and a crowd staged to run around the country saying you are incompetent.

Mr. RUDER. I don't like that at all.

Senator HOLLINGS. For \$500,000, what gives? I think the committee would be sympathetic to some kind of approach immediately to get that cleared out.

Mr. RUDER. We are already increasing that staff by two, which may not sound like a lot, but it is a more than 10 percent increase in that staff, and we are going to try to work on it.

LETTER FROM CHAIRMAN OF COLUMBIA GAS SYSTEM

[CLERK'S NOTE.—The following letter from John H. Croom, chairman and president of the Columbia Gas System was received subsequent to the hearing. By direction of the chairman, the letter has been printed in the record.]

[The letter follows:]

LETTER FROM JOHN H. CROOM, CHAIRMAN AND VICE
PRESIDENT, COLUMBIA GAS SYSTEM

April 17, 1989

The Honorable Ernest F. Hollings
Senate Committee on Appropriations
Subcommittee on Commerce, Justice, State, the Judiciary
and Related Agencies
U. S. Senate
Room S-176A
U. S. Capitol
Washington, D.C. 20510

Dear Senator Hollings:

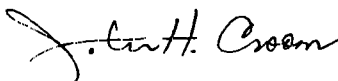
A lack of adequate funding for the Office of Public Utility Regulation (OPUR) at the Securities and Exchange Commission is resulting in serious delays in processing applications for the 12 registered holding company systems regulated under the Public Utility Holding Company Act of 1935. The lack of adequate funding has caused a shortage of key staff which not only will result in the backlog of cases at OPUR growing by 400% between 1988 and 1990, but also will cause delays in the authorities that are issued. These delays are putting these 12 systems at a competitive disadvantage in reacting to dynamic changes in the market for energy and in serving their shareholder and customer interests. Subsidiaries of these systems serve over 18 million electric and gas customers in 29 states.

We respectfully urge that the Appropriations Committee increase funding for the SEC Office of Public Utility Regulation by \$600,000 per year in order to provide for proper administration of the Act.

Attached is a copy of the testimony presented on behalf of the 12 systems in the House Appropriations Subcommittee on Commerce, Justice, State and the Judiciary hearings on April 12. If I can answer any questions, please contact me or Rick Casali at our Washington Office at 842-7403.

Thank you for your assistance.

Sincerely,



John H. Croom

STATEMENT OF JOHN H. CROOM

GOOD AFTERNOON MR. CHAIRMAN AND SUBCOMMITTEE MEMBERS. MY NAME IS RICHARD A. CASALI, VICE PRESIDENT OF COLUMBIA GAS SYSTEM. OUR CHAIRMAN, JOHN CROOM, WAS SCHEDULED TO TESTIFY TODAY, BUT A PRESSING MATTER DETAINED MR. CROOM. THE COLUMBIA GAS SYSTEM, INC. IS A NATURAL GAS UTILITY HOLDING COMPANY REGISTERED WITH THE SECURITIES AND EXCHANGE COMMISSION PURSUANT TO THE PUBLIC UTILITY HOLDING COMPANY ACT OF 1935. I AM TESTIFYING ON BEHALF OF COLUMBIA AND THE OTHER ELEVEN REGISTERED ELECTRIC AND GAS UTILITY HOLDING COMPANIES WITH RESPECT TO PROPOSED ADDITIONAL FUNDING FOR THE OFFICE OF PUBLIC UTILITY REGULATION AT THE SECURITIES AND EXCHANGE COMMISSION.

ALTHOUGH WE ARE ONLY TWELVE COMPANIES, OUR ELECTRIC UTILITY SUBSIDIARIES REPRESENT ABOUT 25% OF THE NATION'S ELECTRIC UTILITY ASSETS, OUR GAS UTILITY SUBSIDIARIES ABOUT 10% OF THE NATION'S GAS UTILITY ASSETS AND OUR GAS PIPELINE SUBSIDIARIES TRANSPORT

ABOUT 20% OF THE NATION'S NATURAL GAS SUPPLIES. COLLECTIVELY, WE SERVE 18 MILLION CONSUMERS IN 29 STATES.

THE 1935 ACT IS UNLIKE OTHER STATUTES ADMINISTERED BY THE S.E.C. WHICH HAVE DISCLOSURE AS THEIR PRIMARY GOAL. THE 1935 ACT REQUIRES THAT THE S.E.C. LOOK AT THE SUBSTANCE OF THE TRANSACTION AND TAKE AFFIRMATIVE ACTION BEFORE REGISTERED HOLDING COMPANIES CAN ENGAGE IN VIRTUALLY ANY CORPORATE TRANSACTION, INCLUDING ROUTINE FINANCINGS. WHILE THE STAFF OF THE OFFICE OF PUBLIC UTILITY REGULATION HAS BEEN ABLE TO PROCESS ROUTINE MATTERS RELATIVELY QUICKLY (APPROXIMATELY 60 DAYS), WITH SUCH A LIMITED STAFF, EVEN ROUTINE MATTERS HAVE RECENTLY ENCOUNTERED DELAYS. FOR AN EXAMPLE, IN 1988, COLUMBIA PROPOSED A SIMPLE REVISION OF EXISTING FINANCING AGREEMENTS THAT WOULD HAVE REDUCED COSTS. UNFORTUNATELY, THE FILING WAS MADE IN THE SUMMER, THE ATTORNEY REVIEWING IT WENT ON VACATION AND THE NOTICE REQUIRED FOR THE ESSENTIALLY ROUTINE TRANSACTION WAS DELAYED THREE WEEKS. THE THREE-WEEK DELAY IN IMPLEMENTING THE NEW AGREEMENT COST THE

COMPANY ABOUT \$200,000. RECENTLY, WE WERE TOLD THAT ISSUANCE OF ANOTHER NOTICE WAS DELAYED BECAUSE THE REVIEWING ATTORNEY HAD TO TAKE TIME TO WORK ON A PENDING RULEMAKING REQUEST. THESE MINOR DELAYS IN ROUTINE ITEMS MAY NOT HAVE DIRE CONSEQUENCES, BUT THEY DO HAVE COSTS.

NON-ROUTINE MATTERS ARE MORE IMPORTANT AND MORE SUBJECT TO DELAY. ANY TRANSACTION WHICH IS OPPOSED REGARDLESS OF THE REASON FOR, OR THE VALIDITY OF, THE OPPOSITION, OR WHICH RAISES A NEW ISSUE REQUIRES SUBSTANTIALLY MORE STAFF ATTENTION. ORDERS CONCERNING SUCH MATTERS GENERALLY MUST BE REFERRED TO THE COMMISSION. THEY, THEREFORE, TAKE MUCH LONGER TO PROCESS AND ARE SUBJECT TO MUCH LONGER DELAYS.

WHAT IS IMPORTANT IS TO STRESS THAT MANY CASES RELATE TO DIRE NECESSITY OR WINDOWS OF OPPORTUNITY AND THAT AUTHORIZATION IS REQUIRED ON A TIGHT SCHEDULE. IN THE PAST, WHEN ADEQUATELY STAFFED, THE COMMISSION HAS MET THESE CHALLENGES AND HAS

ALLEVIATED SERIOUS PROBLEMS. THAT UNFORTUNATELY CANNOT BE SAID ABOUT NOVEL OR CHALLENGED TRANSACTIONS FILED RECENTLY. OUR COMPETITORS -- EXEMPT ELECTRIC AND GAS UTILITIES AND INDEPENDENTS -- ARE NOT SUBJECT TO THE ACT AND THEREFORE TO NO SUCH REGULATORY CONSTRAINTS. IN MANY INSTANCES, THEY ARE ABLE TO SECURE IMPORTANT COMPETITIVE ADVANTAGES OR INDEED THEY MAY USE THE ACT TO BE FREED OF POTENTIAL COMPETITION.

THE GAS AND ELECTRIC INDUSTRIES ARE IN AN ERA OF CHANGE WHICH MAKES NOVEL ISSUES MORE FREQUENT AND THE POSSIBILITY OF OPPOSITION FOR COMPETITIVE PURPOSES MORE LIKELY

DURING 1987, THE COMMISSION ESTIMATED THAT 167 FINANCIAL TRANSACTIONS AND 1,325 REPORTS WERE REVIEWED BY A STAFF OF ONLY 13. TO PLACE THE BURDEN IN BETTER PERSPECTIVE, IT SHOULD BE NOTED THAT OF THE 13, AT FULL AUTHORIZED LEVELS, THERE ARE ONLY 5 ATTORNEYS WHO REVIEW THESE APPLICATIONS. THE STAFF INCLUDES SUPERVISORY PERSONNEL, CLERICAL HELP, FINANCIAL ANALYSTS AND ATTORNEYS ASSIGNED TO EXEMPT COMPANY MATTERS, BUT THE INITIAL

HOURS WILL BECOME AVAILABLE TO PROVIDE FOR THE RULEMAKING TO INCREASE FEES.

IN CONCLUSION, THE REGISTERED UTILITY HOLDING COMPANIES HAVE A VERY IMMEDIATE PROBLEM WITH UNDERSTAFFING DUE TO UNDERFUNDING OF THE O.P.U.R. AN ADDITIONAL ALLOCATION OF \$600,000 TO THAT OFFICE FOR FISCAL YEAR 1990 AND BEYOND IS NECESSARY TO ASSURE PROPER ADMINISTRATION OF THE ACT.

I WOULD NOW BE PLEASED TO ANSWER ANY QUESTIONS WHICH YOU MAY HAVE.

PROPOSED REDUCTION IN 1989

Senator HOLLINGS. Now, the President has just proposed \$2,161,000,000 in supplemental appropriations, but in order to provide for them, he reduces the domestic discretionary programs, namely, the SEC, by 1.099 percent. In other words, he would be cutting you \$1,567,000. Can you absorb that reduction? We were talking a second ago about \$500,000. I don't see how you are going to absorb it, or can you?

Mr. RUDER. No, sir; we estimate that at this time in the year, as you know, we are moving toward the end of our fiscal year, we would be required to actually furlough people in order to accomplish that goal.

Senator HOLLINGS. How many would you have to actually furlough?

Mr. RUDER. Furlough. We would have to take everybody and say, "You are going to have 3, 4, or 5 days off with no pay." That would be a dramatic injury to our program and, I think, would be just terrible for employee morale.

Senator HOLLINGS. Don't even run that rumor around. Tell them we are not going to do it.

Mr. RUDER. We are not going to do it.

Senator HOLLINGS. No, sir; because Senator Rudman and Senator Bumpers, I have just been looking around since January to find at

least one budget that we could feel good about, and I feel good about this one. I think we can put more money in it, and you know, we got so many that are lagging and so many other real needs. If we can just leave you alone and give you some of the money you collect so you can continue on, it looks good to me.

I yield to you, sir.

ASSISTANCE PROVIDED TO JUSTICE DEPARTMENT

Senator RUDMAN. Thank you, Mr. Chairman. I have a couple of observations. First, I agree with the chairman totally. This is not a budget under the current situation that we are faced with to propose any reduction. I think we have to prioritize here.

This committee also funds the Justice Department budget, so we get involved with all of their requests. I think it is fair to state that the cases creating the major workload in Justice in white collar crime over the last 24 months or maybe even longer have come from SEC investigations.

Mr. RUDER. If I could just respond to that, we give the Justice Department a great deal of staff help, and we, indeed, sometimes detail people to their offices in order for them to be able to have the staff expertise. I think we have four people in the New York area?

Mr. LYNCH. We have 4 people who have been detailed to work up in New York, to work on the Drexel grand jury, and that is in addition to the 20 or more people that we had working on the civil investigation—

Mr. RUDER. Gary Lynch, for the record.

Mr. LYNCH [continuing]. And 20 or more people working on the civil investigation in Washington, and the information that we develop in the civil investigation is, of course, available to the grand jury up in New York.

Senator RUDMAN. The reason I raise the point is because, obviously, it is a system that we are talking about, a whole administration of justice system, and we have to look at the whole system. The fact is, Mr. Chairman, that one of the reasons we have the success that we have had on the Department of Justice level, the reason Mr. Giuliani could be as successful as he has been is because he has had the SEC essentially putting together the corroborative evidence through a variety of means.

So I agree with you totally, Mr. Chairman, that this is one budget where somebody was not thinking down at OMB when they simply ran across the board with this relatively small amount of money. It is a major amount to this agency, but even more important, if, in fact, we are going to restore confidence in the capital markets, then there has to be confidence that Mr. Ruder's agency is doing a good job with good people.

CIRCUIT BREAKER PROCEDURES

I have two more questions. First, the market circuit breaker procedures that were announced back in October 1988, how is that working, and do you think that it is adequate to prevent what happened?

Mr. RUDER. We not only have the 250 point decline on the Dow Jones industrial average as a circuit breaker, but we have had, I think, excellent voluntary cooperation between the New York Stock Exchange and the Chicago Merchantile Exchange. They have an interruption phase at about a 100-point decline on the Dow, and that point was reached or nearly reached the other day in the decline, and I am very glad that it was reached in the morning. One of the other portions of this agreement, which was effected the other day in the morning, was a delay in the opening on the Chicago Merchantile Exchange. I think those delays are very healthy.

Senator RUDMAN. The logic behind it is that to keep a free fall from occurring, you give people a chance to draw back, look, think, and not get panicked into the kind of trading that is almost automated now. Is that it?

Mr. RUDER. At the 250 point level, the theory is that we want to avert panic. At the 100 point level, the idea is to provide very small pauses in the market so that people have a chance to look and see what is happening.

SELF-FUNDING STUDY

Senator RUDMAN. The only other question I had, Mr. Chairman, is on the study of self-funding, which is something the Executive Director of the SEC issued at the request of the Senate Banking Committee. The possibility of financing the Commission through the generation of its own fees, obviously, in the last several years, would have been very beneficial for the agency.

I have a problem with self-funding generally, although there is nothing to say you might not have an exception to the rule. I wonder if either you or your Executive Director might like to address that. That study was done at the request of the Senate Banking Committee. I would just like to know why you think you are so different that maybe here is an area that we ought to self fund as opposed to, say, maybe, DEA or some other agency.

Mr. RUDER. I have two answers to that. The self-funding study really has two pieces in it. The first piece involves an evaluation of our pay scales compared to the pay scales of the industry which we regulate. There, the numbers are so dramatically different that we believe we should be relieved of some of the OPM guidelines for pay scales so that we can compete adequately against the securities industry and the law firms for financial examiners, for accountants, and for attorneys.

I think there is very little disagreement about that at our agency and indeed, practically with anybody to whom I have talked.

With regard to the self-funding aspect itself, that portion was an effort to show the relationship between what we bring in and what we spend, and I think, at least from my point of view, the analysis was designed to show what our needs are and to give illustrations of ways in which they could be accomplished.

The Executive Director offered either increases through the regular appropriation process or placing us to the side with complete appropriation and authorization oversight for putting us on to self-funding.

I guess as a lawyer, I would think that we gave the total self-fund funding idea, put it in there as a means of saying, "Well, this would be the ideal way," but we would really be satisfied if we could have an appropriations process every year that would produce the kind of budget that we need.

Senator RUDMAN. I think it was a good study and made some good points. It got everybody's attention. There are always problems with this sort of thing because it is kind of analagous to the small town in which the police department is funded by speeding tickets. There is always some suspicion as to whether or not the ticket should have been given.

I would not say that anybody as professional as the SEC would do a thing like that—

Mr. RUDER. No; we do not advocate the use of our enforcement revenues, but let me make one other point. I characterized us as an enforcement agency, but I would also characterize us as a financial regulator. As the markets are changing, both in the United States and internationally, we have become much more involved with the banking regulators and with international regulators. As you know, the banking regulators in this country are more free from salary restrictions and other budget constraints than we are.

So that I think in that sense, in terms of competing for salaries, we are much more like a financial regulator and deserve that consideration.

INTERNATIONAL REGULATION

Senator RUDMAN. Mr. Chairman, one last question. You have just set off a memory here. Maybe we will make some headlines in Tokyo tomorrow from this hearing. There was a very interesting article written several months ago about what some of the Japanese companies are doing in terms of borrowing money. My understanding is that the price earning ratios of stocks on the Tokyo exchange are just incredible compared to our own. Some of them are selling for hundreds, in fact, thousands of times their earnings in some cases.

My understanding is there is strong evidence that some of these companies have pledged that stock, which has just incredible over-value compared to any traditional American standards, as collateral for loans in American banks. The money is then taken to acquire American assets. Is that something the SEC would get involved in, or would that be something that the Federal Reserve and the regulators would get involved in as to assessing what proper collateral would be in terms of its value?

Mr. RUDER. I am not familiar with the circumstances you suggest, but the question of whether a bank loan in the United States from a U.S. bank to any of its customers is adequately collateralized is a matter for Federal Reserve.

Senator RUDMAN. The SEC would not get involved?

Mr. RUDER. Well, we might be involved in the disclosure area. We would very much want to know whether the bank holding company's disclosure adequately described the collateral which was available, and if it did not, then we would be very concerned.

Senator RUDMAN. Because obviously, if you have a stock selling for \$1,000 and it was earning \$1 a share, it is rather unusual. Yet, I understand that is not unusual in some of these foreign markets for some of that stock to be used as collateral for loans from U.S. banks, the money then being taken right in this country—our own money, if you will—to purchase U.S. assets.

Mr. RUDER. We would be concerned about those price earning ratios in terms of the market strength of the Japanese stock market, but we would get at it not from the question of whether those ratios were right, but what are the disclosures of risk by the bank?

Senator RUDMAN. Thank you very much. Thank you, Mr. Chairman.

Senator HOLLINGS. Senator Bumpers?

BOUNTY HUNTER PROVISIONS

Senator BUMPERS. Thank you, Mr. Chairman.

Dave, your appearance here today is really propitious for me, because this afternoon at 2:30, we are going to take up Senator Metz-enbaum's so-called whistleblower bill. It deals with the encouragement of people to blow the whistle under any Government contract worth more than \$1 million. I think defense procurement fraud prompted it. But there is a provision in there, Section 2, which I intend to move to strike, and it is the so-called bounty hunter provision.

I am offended by that, and we have done this before. There is precedent, and that is going to be the argument this afternoon against my motion to strike. But I am increasingly concerned about this sort of KGB attitude we are developing in this country about encouraging people to level charges. Usually it is a disgruntled employee.

When I was Governor, every time somebody got fired, they wanted to see the Governor, and they would all come into me about the hanky-panky that was going on in their office, all the fraud and so on, but they never found an excuse to talk about it until they lost their job.

The IRS does this. I grew up in a small town where everybody knew everybody else's business, and every time the IRS audited somebody, everybody knew it and everybody started speculating about who turned them in. [Laughter.]

Senator RUDMAN. That was quite a town.

Senator HOLLINGS. I don't know how you got elected. [Laughter.]

Senator BUMPERS. Of the 1,500 people in the town, there were always 3 or 4 guys that the attention focused on as to which one turned this guy in. Every time somebody bought a Mercedes—Well, there weren't any Mercedes in my home town, but any time anybody bought a new car or built a new home, everybody suspected he was cheating on his taxes.

I didn't know it until I stopped in the coffee shop one morning. I had been practicing law for a long time. And somebody told me there is a fee for this. That you can get up to 10 percent of whatever the recovery is.

That is not quite as bad as the Metzenbaum provision or this insider trading provision that we put in last October, because that doesn't depend on a conviction.

So you testified over in the House last summer on this so-called Insider Trading Sanctions Act. Here is the provision in that bill.

Notwithstanding the provisions of subsection d(1) there should be paid from amounts imposed as a penalty under this section and recovered by the Commission or the Attorney General, such sums, not to exceed 10 percent of such amounts, as the Commission deems appropriate, to the person or persons who provide information leading to the imposition of such penalty. Any determinations under this subsection including whether, to whom, or in what amount to make payments, shall be in the sole discretion of the Commission, et cetera.

Without going any further, it says "any determination shall be final and not subject to judicial review."

There again, there is a certain arbitrariness about that. The Commission will decide. Under the Metzenbaum bill this afternoon, the Attorney General will decide. The Attorney General, for example, if there is a fraud down in the Pentagon and he thinks it is going to embarrass the Republican administration or whoever happens to be in the White House, he probably wouldn't deem it appropriate to provide that.

Last week, you probably saw in the Wall Street Journal, a fellow that worked for the Singer Corp. He worked for Singer and then he went out and worked for the Department of Defense, and he had thought Singer was defrauding the Government when he worked. Apparently, he knew they were defrauding them. He knew they were keeping two sets of books. After he went to work for DOD, he suddenly realized he could make \$50 million by turning Singer in. He said in this Wall Street Journal story, "I wouldn't have done it, but I saw a chance to make myself \$50 million."

I am just offended by that. I have got your comments here today from your testimony. You said that:

Personally speaking, I have always been troubled by the bounty concept, and I had hoped that within the industry, we would encourage people to come forward and tell what's wrong with that industry based upon the ethical and moral principles which exist in that industry. We should not be in the position of having to pay them for doing what they should be doing anyway. I'm not speaking for the Commission, but for myself. I think in an industry which has high standards that it may be an anomaly to think that we would then have to pay people for doing what they ought to do.

Now, these people who get teary-eyed singing the National Anthem and saying the Pledge of Allegiance and who don't go vote or who want to turn their neighbors in, that is the way the KGB operates; that is the way Hitler operated, and I am telling you, we have gotten to where we are just moving further and further down the line, and I am going to try to bring a halt to it.

My question is: Do you have any comments in addition to what you said here in this testimony?

INSIDER TRADING AND SECURITIES FRAUD ENFORCEMENT ACT

Mr. RUDER. Well, I have to explain to you, sir, that when the insider trading bill was passed last summer I was asked whether I favored the bill, and I did indicate that I favored the bill.

But I was not asked specifically whether I favored that portion of the bill, and if I had been asked that, I would have reaffirmed my

testimony earlier in the year in which I said I thought the bounty provision was not a good provision.

I have had some long experience with what we call an honor code, at Wisconsin University where I got my law degree, and personally, although I thought the honor code was a good idea, I found the idea that there should be a squeal provision incorporated into that honor code to be something that was very troubling. I don't really believe that we ought to have a society in which we reward people for telling on their neighbors.

I must say, I think there are ethical standards which would cause an individual to reveal crime if he knows about it, but I think being paid for it is not the right way.

Senator BUMPERS. I want you to know, I appreciate your comments very much. Those are my feelings precisely. I just think this country is moving too much that way. We ought to be teaching patriotism and citizenship without grounding rewards for it. You also pointed out two things.

No. 1, you have to stop and investigate every allegation, no matter how specious it may be; I know the bureaucratic political mentality. Fritz Hollings and Warren Rudman and Bob Kasten and I do stupid things all the time to avoid the appearance of impropriety, because it is not worth one story in the newspapers.

So you would have to stop, use the resources to the very limit, which is what you are testifying about, investigate every kind of a crazy allegation from every disgruntled employee, so you are going to be using up resources that way. No. 2, if you do wind up in court, I was a trial lawyer as you know, and I would just love to get one of those guys on cross examination. [Laughter.]

I promise you, I can spring my client almost every time when I have got a stoolie sitting on the stand.

I feel very strongly about it, Mr. Chairman. I hope you will join me this afternoon.

Senator HOLLINGS. I am against stoolies. [Laughter.]

Senator BUMPERS. One last question.

Senator HOLLINGS. Yes.

Senator BUMPERS. Incidentally, Dave, my daughter was admitted to Northwestern yesterday.

Senator HOLLINGS. You went to Northwestern Law School.

Mr. RUDER. I was dean.

Senator BUMPERS. He was much older.

Senator HOLLINGS. You must have passed.

Mr. RUDER. I gave him passing grades.

Senator BUMPERS. He was dean when I was there. You can see he was a lot older than I was. [Laughter.]

PUBLIC UTILITY HOLDING COMPANY USER FEES

But the other thing is, the utility companies are making an interesting proposal on user fees, and they are asking that we go up by \$2,000 from \$4,000 to \$6,000 per application based on the fact that you don't have the resources to process those applications as quickly as you would like, as they would like. How do you feel about that proposal?

Mr. RUDER. I have to say, I do need the money. I will accept it, sir, and use it for the purpose for which it is appropriated.

Senator BUMPERS. Are they right? Could you get that work done a lot faster if you had that fee in place?

Mr. RUDER. Oh, yes; the problem has been that there has been this indication that the Public Utility Holding Company Act will be repealed and in expectation of that repeal we cut our staff back. Now, instead of having it repealed, it is becoming much more complicated to administer, so we really do need the funds, and I think it would be beneficial to us to have specially allocated funds to be able to administer the act.

Senator BUMPERS. Do we need to do that legislatively? We are not the authorizing committee that would permit that, but do we have to do that legislatively? You can't raise that fee administratively?

Mr. RUDER. I don't think we can.

Ms. McGRATH. We can't raise the fee without legislative help.

Senator HOLLINGS. The chairman testified that \$500,000 more was needed, right?

Mr. RUDER. Yes; but there must be legislation to authorize the increase in the fees. It is not within the level of fees that we can raise.

Senator HOLLINGS. But we can still appropriate that \$500,000.

Senator BUMPERS. We would also have to raise his authorized personnel level.

Senator RUDMAN. Mr. Chairman, if you will yield for just a moment for a question. What we will have to do, as we have done in the past, we are going to have to do that in this committee, even though we are not the authorizing committee, in order to get the proper offset in our budget allocation. We are going to have to do it like we did a few years ago with regard to the immigration fees.

Senator BUMPERS. Mr. Chairman, I came here because Dean Ruder and I have been very good friends for many years. He is an outstanding man. He ain't enough Republican to hurt. [Laughter.]

Senator HOLLINGS. And he is enough Republican to stay on. I want you to know I want you to stay on. Have you gotten any indication?

Mr. RUDER. Things are still in limbo, sir.

Senator BUMPERS. Thank you very much.

Senator HOLLINGS. Thank you.

Senator KASTEN.

Senator KASTEN. Mr. Chairman, I have no questions. I just want to thank and congratulate David for the outstanding job he has been doing. I understand some of the questions that I might have asked have already been covered. Thank you very much for everything you are doing.

Mr. RUDER. Senator Kasten can claim me as having my birthplace in Wisconsin, sir. I would like my loyalty to be here.

COMPARABLE SALARIES

Senator HOLLINGS. Let me ask a comparative between the financial banking world, let's say the Federal Reserve salaries and SEC salaries. Are they comparable? You were talking about being able

to pay. You have asked for a waiver from the Office of Personnel Management.

Mr. RUDER. The Federal Deposit Insurance Corporation, I can't quantify this, but the Federal Deposit Insurance Corporation has been paid salaries at higher levels than we were paid for many, many years, and I understand that Chairman Greenspan has recently decided to exercise the authority which he has to increase salaries at the Federal Reserve Board.

Senator HOLLINGS. Can you have staff look into that and give me a little comparison so I will know?

Mr. RUDER. Yes; I can.

[The information follows:]

COMPARABLE SALARIES

The Federal Reserve study to determine market based salaries is nearing completion but has not been released.

The Federal Deposit Insurance Corporation [FDIC] uses the Office of Personnel Management GS/GM pay scale. However, that scale is adjusted by region for the cost of living. The cost of living is reviewed each year and modified periodically. In the Washington, DC, area, the current adjustment is 9.5 percent.

FOREIGN REGISTRATION REQUIREMENTS

Senator HOLLINGS. Then one educational question at least for me and maybe for Senator Kasten. Before our Commerce Committee, we have, I think it is the Bryan or Hughes amendment to require the same registration information of a foreign entity, namely, a privately held company as it is required for a domestic privately held or a publicly held company. Are you familiar with that amendment at all, where the argument has been that the foreign corporations come over and they don't have to file?

We require a greater deal of filing for ours and less than ours is required overseas. Are you familiar with that amendment at all? It passed the House and came before the Senate. It was voted down on a threat of veto.

Mr. RUDER. I am not familiar with it in detail, no, sir, but I can tell you that it is a very difficult problem. We have a special rule which allows certain foreign corporations to use their home country disclosure documents and have securities traded in our market within limits, and that does make our domestic companies unhappy.

Senator HOLLINGS. There is an inequity.

Mr. RUDER. There seems to be an inequity. Yet, I am very loath to urge change here, because if we don't allow those companies to trade in our markets, then our investors are not going to be able to take advantage of the opportunities to buy securities of those companies unless they go overseas, and if they go overseas, that means that our capital markets are not going to have those transactions in the United States.

It is a very difficult question in terms of not forcing activities overseas which could exist in the United States.

Senator HOLLINGS. I understand that. What I am trying, I guess, to get at is the differential in the actual information which we obtain from a domestic corporation as compared to the foreign, and when the foreign comes in, my understanding is we are not requir-

ing that information whatever. We know nothing about some of these companies, or particularly, I guess you wouldn't have a privately held company in this country, so the comparable would not be there, or differential, but at least we ought to be knowing more about the companies that are coming in and who is holding what and what influences and what-have-you.

You have no feel about that at all?

DISCLOSURE REQUIREMENTS FOR FOREIGN COMPANIES

Mr. RUDER. I would like to actually have the Director of our Division of Corporation Finance give you an indication of the difference in the disclosure requirements for foreign companies as opposed to domestic companies. Would you do that, Ms. Quinn?

This is Linda Quinn.

Ms. QUINN. With respect to registration where they are offering securities in the United States, we have a special set of requirements which have some modification for foreign issuers, but in large part, are quite similar. The financial statements have to be reconciled to U.S. standards, and so thus with respect to the offering of securities over here, while there is a difference, I would suggest it is not a major difference.

Foreign issuers do not have to file quarterly interim reports as our domestic issuers do. The rule that the Chairman was speaking to is for those foreign issuers' securities that are held here and not traded in the public market. They are not traded on an exchange and they are not traded in NASDAQ, that is, companies who may not have voluntarily come to the United States but whose securities have been bought by U.S. investors and are now held here. Such companies are not compelled to comply with our disclosure requirements because they have not taken the voluntary step of entering the public market.

I am not certain, but it may be that the legislation you are referring to is focusing on those companies who are coming here to invest in U.S. securities and it may be a 13(d) orientation, although I am not familiar with the legislation. There, a foreign person who owns more than 5 percent of a class of stock would be subject to the 13(d) requirements that are applicable to our domestic investors. So, we wouldn't see a difference between what they have to provide and what our U.S. investors have to provide. I am not familiar with the legislation.

Senator HOLLINGS. Well, I will confer further. I appreciate it very much.

Senator RUDMAN. I am all set.

BOUNTY PROVISIONS

Senator BUMPERS. One final question. In the *Boesky* and the *Milken* cases, did the SEC develop those cases or was there a whistleblower who came to you?

Senator HOLLINGS. A stoolie? Did a stoolie develop it? [Laughter.]

Mr. RUDER. No; the Levine investigation, which pre-dated the Boesky investigation, came from a letter which came to Merrill Lynch, and Merrill Lynch then gave us the letter, and our staff

then followed that letter through and engaged in the investigation itself. It was not, at that point, it was not a stoolie provision.

I must say that Bank Leu in the Bahamas told us about Levine, and Levine told us about Boesky, and Boesky told us about Drexel, so there is that kind of information going on, but that is not—

Senator BUMPERS. None of those people are entitled to a fee, either, because that provision wasn't in effect then.

Mr. RUDER. They wouldn't get a fee from us. [Laughter.]

Senator BUMPERS. I don't know. Is there a provision in the Insider Trading Act saying a participant is not eligible?

Mr. RUDER. Only in our discretion, and I can assure you that a participant would not have any chance.

Senator BUMPERS. There is no absolute bar to them getting a fee. It is in your discretion, even though they are wrongdoers.

Mr. RUDER. That is right. There is no bar.

Senator BUMPERS. I will say this for Metzenbaum's bill. He has a provision in there that a participant in the crime is not eligible for a fee.

Mr. RUDER. It is going to create very difficult litigation problems for anybody who wants to resist that, and the other question, Senator, that bothers me about it is that the veracity of the witness who turns over, who gives you the information, is immediately suspect because of the fact that—

Senator BUMPERS. If he is there as a good citizen, you will get a conviction. If he is there because he is going to get a big fee, a guilty person is probably going to go free.

Senator HOLLINGS. That was the feeling with the U.S. attorney. If I am Boesky and I rat on the next fellow, then I get a lesser term? Is that involved in this case?

Mr. RUDER. I would rather not speak about the particular case, but in some cases, a person who is cooperative receives a lesser penalty than he would otherwise receive, and I think that is good law enforcement.

Senator RUDMAN. Mr. Chairman, any prosecutor can tell you, as I can tell you, that given a choice, you always will go with an unpaid informant rather than with a paid informant. The prosecution problems are immense when you put in a paid informant, particularly my own recollection in drug cases as a prosecutor. You put a paid informant on and people like Bumpers have a field day.

Senator HOLLINGS. There you go.

CORRESPONDENCE FROM INVESTMENT COMPANY INSTITUTE

[CLERK'S NOTE.—The subcommittee has received the following letter from the Investment Company Institute. By direction of the chairman, the letter has been printed in the record.]

LETTER FROM DAVID SILVER, PRESIDENT, INVESTMENT
COMPANY INSTITUTE

April 24, 1989

The Honorable Ernest F. Hollings
Chairman
Subcommittee on Commerce, Justice and
State, the Judiciary, and Related Agencies
S-146A Capitol Building
Washington, D.C. 20510

Dear Mr. Chairman:

I am writing on behalf of the Investment Company Institute to express our belief that the level of funding for the Securities and Exchange Commission is inadequate and should be substantially increased.

We are concerned that unprecedented and growing complexities of the securities markets, when combined with the pressures of national budgetary considerations, may threaten the SEC's ability to pursue vigorously -- as it has with distinction for the past fifty-five years -- its fundamental statutory mandate to act in "the public interest" for the "protection of investors." While the mission and apparent scope of the SEC's responsibilities have remained essentially constant over the years, the problems it faces domestically and internationally, and the sheer volume of activity within its regulatory ambit, pose vast new challenges.

The Committee has before it statistical data as to the substantial increase in the Commission's workload in recent years, which make a compelling case for substantial budget increases. I thought it might be helpful to take an even longer overview -- 25 years -- which suggests that there may have been an even greater erosion of the SEC's capabilities than is suggested by short-term comparisons.

The starting point is the SEC's human resources. In 1963, the SEC was authorized to have 1,481 employees. I understand that under current budgetary constraints the Commission may be limited to 2,050 in the coming year. This would represent a 38 percent increase in staff over the past quarter century. But a comparative review of SEC supervised activities as between 1963 and 1988 raises serious doubts as to whether the SEC has the human resources to discharge effectively its responsibilities.

In 1963, the average daily volume of trading on the New York Stock Exchange was 4,566,000 million shares per day; in 1988 trading volume equalled 164,460,000 million shares per day -- an increase of 3502 percent.

In 1963 there were 5,482 registered broker-dealers and 679 applications for new registrations; in 1988 there were 12,140 registered broker-dealers and 2,204 new applications -- an increase of 121 percent in registrations and 225 percent in applications.

In 1963 there were 1,564 registered investment advisers and 285 new applications; in 1988 there were 14,120 registered investment advisers and 3,360 new applications -- an increase of 803

percent in registrations and 1079 percent in applications.

In 1963 there were 727 registered investment companies with 48 new registrants; in 1988 there were 3,500 registered investment companies and 1,569 new registrations -- an increase of 381 percent in registered companies and 3169 percent in new registrations.

In 1963 the first major insider trading case -- Texas Gulf Sulphur -- was still in the future; in 1988 the "big" case is almost routine. In 1963 internationalization posed no enforcement problems. Today a growing number of securities frauds have an international aspect.

In 1963 there was no separate enforcement division at the SEC; what existed was a small office of a few dozen employees located within the predecessor of today's Division of Market Regulation. Today the Division of Enforcement is a major arm of the SEC employing 749 people.

In 1963 user fees collected by the U.S. Treasury under the securities laws accounted for only 19 percent of the SEC's budget; in 1988 such fees accounted for 184 percent of the SEC's budget.

The tremendous increases in the number of broker-dealers, investment companies, investment advisers, and trading volume are typical of the securities markets as a whole. This growth has created enormous quantitative differences and important qualitative changes in the kind of regulatory oversight and enforcement activities required of the SEC.

For example, increased public participation in the markets and revolutionary developments in communications technology have served to create an environment conducive to the perpetration of widescale fraud on a nationwide basis -- as in the current "penny stock" phenomenon -- which, in the absence of an enforcement capability with a swift response time, can harm many thousands of small investors before being stopped. At the same time, new, complex financing and trading techniques and internationalization have given rise to "big" cases which consume tremendous enforcement energies. Some cases may simply not be pursued because of insufficient resources.

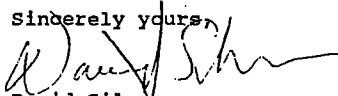
Additionally, competitive developments and innovation within the securities industry, over time, creates the need for new and different regulation -- regulation which protects the public but also affords industry the flexibility necessary to foster healthy innovation and robust competition both nationally and internationally. An understaffed agency is much more likely to miss the mark in one direction or the other -- and either overregulate or underregulate.

Thus, whether one takes a short or long view, it is clear that the SEC is underfunded and understaffed. The greatest irony is found by comparing user fees collected by the U.S. Treasury under the securities laws: In 1963 these user fees represented a small fraction of the total SEC budget; currently user fees are approaching twice the size of the current budget. Clearly, 1963 investor protection activities conducted by the SEC were considered to be critical enough to warrant the expenditure of general revenues to subsidize these activities. Now, investors and industry are being required to pay far more than the SEC receives in appropriated funds. The investing public and the

industry are thus not receiving the services from government which they need, and, as these figures show, they are not receiving the services for which they pay. This should be rectified.

Thank you for the opportunity to present our views. We would be most happy to provide you with such other information which you might find helpful.

Sincerely yours,



David Silver

ADDITIONAL COMMITTEE QUESTIONS

Senator HOLLINGS. If there is nothing further, we will be submitting some additional questions for your response for the record.

[The following questions were not asked at the hearing, but were submitted to the Commission for response subsequent to the hearing:]

QUESTIONS SUBMITTED BY SENATOR ERNEST F.
HOLLINGS

MARKET REGULATION

QUESTION:

Mr. Ruder, in your statement you say that the "October 1987 market break dramatically emphasized the Commission's role in the regulation of financial markets." Please give us a brief summary of what the SEC has done over the last 18 months in response to the market break.

ANSWER:

The SEC has undertaken a number of important initiatives in response to the October 1987 market break. One of the initial actions taken by the SEC was the preparation of a comprehensive study of the causes, effects, and regulatory ramifications of the market break. The study was conducted by the Division of Market Regulation to provide the Commission with a factual basis to determine the appropriate regulatory responses to the October 1987 market break. The study examined the entire range of market reactions from specialist performance to the role of derivative markets and the operation of clearance and settlement systems.

In this connection, the SEC has recommended numerous legislative market reforms in the course of testimony before various Congressional committees and subcommittees and as an active participant in the President's Working Group on Financial Markets. In addition, the SEC has formulated and transmitted to Congress a number of legislative proposals designed to improve market oversight and performance. The legislation addresses such issues as emergency Commission authority over securities trading; reporting of large securities positions and of the activities of holding company systems; and coordination of clearance and settlement, among other matters.

The SEC, and the securities exchanges, have also implemented a number of administrative market reforms, including many of those recommended by the SEC in its study and subsequent Congressional testimony. For example, the equity and options exchanges, in conjunction with the futures exchanges, have implemented detailed circuit breaker provisions to halt trading and provide priority market access to individual investors during periods of market volatility. In addition, the SEC has approved margin increases applicable to short positions in equity and index options and has approved a proposal to permit cross-margining of options and futures. The SEC also has overseen implementation of exchange reporting requirements regarding program trading activity and efforts to enhance the systems capacities of the exchange and NASDAQ markets. Last, the SEC has approved enhanced capital requirements applicable to certain exchange specialists and is considering a number of additional changes to equity and

option specialist net capital requirements and to the overall minimum capital requirements for broker-dealers.

QUESTION:

Mr. Ruder, how do you feel about the market today? Would you encourage individual investors to return to the stock market?

ANSWER:

Overall, the U.S. securities markets are a much safer place for individual investors than they were during and in the immediate wake of the October 1987 market break. This is due primarily to the significant decrease in market volatility. In addition, since the market break the exchanges have implemented a number of systems enhancements that should help the exchanges better cope with future periods of market stress. These enhancements include increased stock and options exchange volume capacities, as well as procedures designed to provide priority market access to individual investors during periods of market stress.

I would encourage individual investors to return to the market, but with one caveat. Although day-to-day volatility is down, the markets still are subject to periodic, short spells of relatively acute intraday volatility. Accordingly, individuals interested in long-term investment are much less likely to be affected by market fluctuations than those interested only in relatively short-term gain.

QUESTION:

A recent article in the New York Times, "S.E.C. Proposing Less Disclosure," (1/24/89), was critical of proposed rule 144A, which would expand the market for private placements not subject to SEC disclosure rules. How does this change expand consumer confidence in the market?

ANSWER:

Proposed Rule 144A is intended to define a class of resales of securities by persons other than the issuer that, as a per se matter, do not involve a public offering and therefore do not create registration obligations. While institutional resales currently take place without registration, Rule 144A attempts to address legal and practical uncertainties concerning this industry practice.

Since the passage of the Securities Act in 1933, issuers have raised capital in transactions that, as permitted by Section 4(2) of that statute, take place without registration and, thus, without specific mandated disclosure requirements. Rule 144A does not change Section 4(2); rather, it clarifies the legal analysis that applies

to resale transactions that take place after an issuer first offers and sells its securities.

Adoption of Rule 144A will also not alter the continuous reporting obligations imposed on publicly-owned companies by the Securities Exchange Act of 1934. That statute requires publicly-owned companies to file periodic reports with the Commission that provide all information about the issuer that must be included in a registration statement filed in connection with a public offering of securities. Under the Commission's integrated disclosure system, Exchange Act periodic reports may be incorporated by reference into registration statements and are the principal source of information about the issuer of securities. The Commission has no reason to believe that Rule 144A will affect the level or quality of disclosure provided to the markets by publicly-owned companies.

In summary, by providing a framework in which qualifying institutional resales can be freely made, Rule 144A should increase the efficiency and liquidity of the private placement market. This, in turn, could attract an increasing number of issuers to the U.S. private placement market by lowering the costs traditionally imposed on both issuers and investors in private placements. A broader, more efficient, and better defined marketplace should promote investor confidence and expand investment opportunities.

QUESTION:

The Budget for Market Regulation includes an additional 27 positions. How many of the increase will be used to establish the capital markets unit?

ANSWER:

Five staff years will be used to create the new capital markets unit. This unit will evaluate the internal controls regarding inventory risks and operation of automated systems of broker-dealers and their unregulated affiliates. This unit will obtain the information necessary for the Commission to carry out its responsibilities as a financial regulator. The October 1987 market break dramatically demonstrated the linkages between the U.S. markets and the other global trading markets. The broad scope of the proprietary trading of broker-dealers and their unregulated affiliates has made their financial viability a central concern in the global banking and monetary system. Other nations, as well as the other financial regulators in this country, look to the Commission to be knowledgeable about the businesses of the major broker-dealers it regulates and to enforce compliance with the federal securities laws.

In addition to carrying out its own risk assessments, this unit will coordinate and provide leadership for broker-dealer examiners, particularly those located in the New

York Regional Office and at the New York Stock Exchange, who have responsibility for examination of the nation's largest securities firms. Expansion of this unit in the future is expected.

QUESTION:

In October 1988, the Commission established a Task Force to protect investors from fraud in the sale of "penny stocks." Are sufficient resources available to combat penny stock fraud?

ANSWER:

Combating penny stock fraud is a major priority of the Commission. In 1988, the Commission initiated more than 25 enforcement actions involving fraud or abuse in the penny stock market. Since 1986, one regional office alone has initiated more than 30 cases involving penny stock abuse. In addition, in 1989, the Commission suspended over-the-counter trading in well over 100 penny stocks.

The Commission's broker-dealer examination program has uncovered strong evidence that misconduct in penny stocks is continuing. In the summer of 1988, the staff conducted a special series of examinations of penny stock broker-dealers. Of the 17 examinations initially done, 14 resulted in enforcement referrals. Possible violations uncovered included abusive distribution and trading of blank check offerings; excessive, undisclosed markups; parking securities in nominee accounts; failure to supervise securities salespersons; and selling by unregistered salespersons.

The Penny Stock Task Force also includes representatives of each of the Commission's operating divisions and regional offices. Its purpose is to identify the problems posed by penny stock manipulation, to consider regulatory solutions to these problems, and to educate investors on the dangers of ongoing stock fraud. The Task Force also seeks to improve coordination with other law enforcement agencies.

To deal with this major, nationwide problem, increased resources may be needed in future years.

DREXEL BURNHAM LAMBERT MATTER

Last week, Michael Milken of the Drexel Burnham Lambert Inc. was indicted on 98 counts of fraud, racketeering, insider trading, and manipulation of stock prices by a federal grand jury in New York. In addition, the SEC in September 1988 filed a 184-page civil complaint against Milken and Drexel. In December, the U.S. Attorney in New York announced a plea bargain in which Drexel admitted that Milken had engaged in fraudulent schemes but that plea bargain has not yet been finalized in court.

QUESTION:

Please summarize the SEC efforts in this matter.

ANSWER:

The Commission commenced an intensive investigation of this matter beginning in about September, 1986 and continuing to the present date. As you have noted, this matter led to the initiation of a civil action against Drexel Burnham Lambert Incorporated and seven other defendants in September, 1988. This matter is the most time-consuming investigation conducted by the Commission. Through March 14, 1989, the Commission had expended in excess of 75,000 staff hours in this matter representing over 35 staff years of effort. While information on travel expenses and litigation costs is not readily available, they have been extensive. Thus, for example, the Division of Enforcement has hired three extra paraprofessional support personnel simply to assist in the litigation of this matter and maintain the huge quantity of documents which have been accumulated. The litigation will also require the retention of a professional copying and microfilm firm to copy the millions of pages of documents and the acquisition of sophisticated personal computers to manage data.

In addition to making the fruits of this extensive investigation available to the U.S. Attorney's Office for the Southern District of New York, which is handling the criminal indictment, the Commission has detailed four attorneys and two investigators on a full time basis to the U.S. Attorney's Office to assist in the Drexel, Milken, and related cases. Indeed, these personnel form nearly half of the prosecution team.

On April 13, 1989, the Commission announced that it had reached an agreement with Drexel resolving the Commission's action against that firm. The settlement calls for Drexel to consent to a wide ranging permanent injunction, to restructure the operations of its business, to appoint personnel acceptable to the Commission to a variety of key positions, to cooperate with the Commission's ongoing investigation, to cooperate in a wide-ranging review of Drexel's compliance operations, to finance a review of Drexel's trading activities by an accounting firm of the Commission's choosing and at the Commission's direction, and to cooperate with measures to be taken by the Commission to monitor the operations of Drexel's High Yield Bond and Capital Markets Services Departments, among others, over the next three years. The settlement also establishes a structure for distributing \$350 million to injured persons.

Although the settlement resolves the Commission's case against Drexel, it does not reduce the burdens that this matter imposes on the Commission. The Commission's litigation against Michael Milken, Lowell Milken, Victor

posner and other defendants is continuing. In addition, the Commission is pursuing a series of urgent and time consuming investigations into other misconduct by Drexel employees and others as well as the possible failure of managers and others to adequately supervise employees with a view to preventing violations of the securities laws. In addition, the Commission staff will be heavily engaged in monitoring Drexel's High Yield and other relevant departments in order to detect possible future violations of the law.

QUESTION:

How much has the SEC invested in manpower and funds to the investigation?

ANSWER:

Since the beginning of the Drexel case, the SEC estimates that it has devoted approximately 35 staff years for an estimated cost of \$1,712,000 in salaries and benefits and a cost of \$930,000 in other overhead expenses for a total estimate of \$2,642,000. We anticipate that the future investment will be even greater.

QUESTION:

Please explain the racketeering element in the indictment.

ANSWER:

The indictment alleges that Michael Milken, Lowell Milken, Bruce Newberg and other unnamed co-conspirators engaged in a racketeering conspiracy through Drexel's High Yield Bond Department to enrich themselves through unlawful securities transactions, through related corporate finance and merger and acquisition transactions and through the influence and control over the financial markets they derived from their unlawfully achieved power. The indictment alleges that Drexel and its parent company, Drexel Burnham Lambert Group Inc., was a racketeering enterprise which achieved its unlawful purposes through a pattern of acts which included mail fraud, wire fraud and fraud in the sale of securities. The means and methods of the conspiracy were alleged to include insider trading, false filings regarding the true ownership of securities, manipulations of the price of securities, falsification of official books and records, the maintenance of secret records of unlawful activities, and unlawful assistance to the co-conspirators. Michael Milken is alleged to have been the leader of the conspiracy. Lowell Milken was alleged to have been Michael Milken's chief adviser who also assisted in resolving disputes involving co-conspirators and Bruce Newberg is alleged to have managed Drexel's unlawful arrangement with Princeton/Newport Partners and to have directed unlawful trades with that firm.

The indictment alleges three principal unlawful arrangements. The first was an arrangement with Ivan F. Boesky and his affiliated companies in which Boesky agreed to secretly buy and sell securities at the direction of Milken in return for assistance in raising financing and a share of the profits from the illegal enterprise. The second was an arrangement with Princeton/Newport Partners in which Princeton/Newport took secret securities positions for Drexel's benefit for the purpose of manipulating the price of securities while Drexel, in turn, assisted Princeton/Newport in generating bogus tax losses through pre-arranged securities transactions. The third arrangement was the use of material nonpublic information misappropriated by the defendants from Drexel clients to purchase securities through Drexel's proprietary accounts.

QUESTION:

Are the news accounts of the pleas bargain correct that it includes an admission by Drexel that Milken had engaged in two separate fraud schemes? If so, are those crocodile tears that Drexel shed last week about Milken now having a chance to clear his name?

ANSWER:

Drexel has stated publicly that it cannot contest the six counts of violation alleged in the information filed by the United States Attorney on January 29, 1989. The information alleges that the unlawful arrangement between Drexel and Ivan F. Boesky and his affiliated companies was conducted through a senior employee of Drexel's High Yield Bond Department and others. The subsequent indictment of Michael Milken and others makes it clear that the senior employee referred to in the information is Michael Milken.

Once the United States Court of Appeals for the Second Circuit permits the Commission to present the agreed upon final judgment to the district court for entry, Drexel will submit a consent and undertaking to the district court in which it states that it consents to the entry of the final judgment "without admitting or denying" (emphasis added) the allegations of the Commission's complaint filed on September 7, 1988.

QUESTION:

Is Milken opposing the plea bargain because Drexel is admitting that he committed fraud?

ANSWER:

Michael Milken has stated that he is opposing the plea agreement on the ground that its provisions requiring that Drexel not employ him following entry of the plea and that Drexel not compensate him for work allegedly performed by him in 1988 are unconstitutional. Milken contends that

these provisions deprive him of property without due process of law and constitute an unconstitutional taking of his property.

QUESTION:

The government is seeking \$1.8 billion in restitution from Milken, his brother, and a third Drexel employee. While Mr. Milken is reported to have made an astonishing \$550 million in 1987, is it really expected that the defendants have assets anywhere near that amount?

ANSWER:

As part of the racketeering element of the criminal indictment, the grand jury alleged that Drexel and its parent company, Drexel Burnham Lambert Group, Inc., was a racketeering enterprise as defined by 18 U.S.C. §1961(4), and that the unlawful proceeds from the pattern of racketeering acts were paid in the first instance to Drexel and then passed through Drexel to the individual defendants in the form of compensation and stock ownership in Drexel. The indictment seeks the forfeiture of the defendants' salaries from 1984 through 1987, their stock ownership in Drexel Group, fees and trading profits obtained by Drexel in connection with allegedly unlawful transactions, commissions and other items derived from the alleged racketeering enterprise.

In pretrial proceedings, Michael Milken was required to segregate approximately \$400 million in cash and other assets as collateral and execute a promissory note for \$300 million (itself collateralized by other property) as security for the forfeiture sought by the indictment. Lowell Milken is required to post \$350 million in cash and a \$20 million promissory note as security while Bruce Newberg is required to post \$1.6 million in liquid assets.

EDGAR

QUESTION:

We understand that the SEC can reduce its 1990 budget request by \$5 million for the Edgar project and \$.6 million for the creation of a central registration depository (CRD) -- The former due to a selection in 1989 of an Edgar operational contractor, and the latter due to identified regulatory and procedural matters which will postpone implementation of a major portion of the CRD until 1991. Can the Congress thereby assume the SEC's true budget request in 1990 is \$163.1 million rather than \$168.7 as submitted?

ANSWER:

No. The SEC requires its full request of \$168.7 million to cover unfunded costs. Should the \$3.7 million for the January 1989 pay raise not be provided, the SEC would

suffer a programmatic reduction of approximately 80 staff years. This reduction would be experienced across all program activities.

	\$(mil)
Funded by OMB	168.7
Savings-	
Edgar	(5.0)
CRD	(.6)
Balance	163.1
Unfunded costs-	
Balance of January	
1989 pay raise	3.7
Computer purchase (Doubling of lease savings)	.6
Office space requirements (NYRO, LARO and HQ)	.4
Reduce SEC lapse rate by 18 staff years to 7.5%	.9
Revised Balance	168.7

QUESTION:

What is the status of the EDGAR Operational contract? What is the total cost of the contract?

ANSWER:

The eight year contract for the design, development and operation of the EDGAR system was awarded to the BDM Corporation on January 3, 1989. Bidding with BDM were Mead Data Central, Sorg Incorporated and Bechtel Information Services.

The contractor is currently working closely with SEC staff members on the detailed design of the Operational system. A development plan has been drafted which calls for conversion of the EDGAR Pilot filers to the Operational system in mid-1990. The first mandated group of test filers is expected to be phased onto the system in late 1990.

The total estimated cost of the contract is \$51.5 million. This estimate does not include the cost of equitable adjustments and technological upgrades that will be necessary at a later date.

PUBLIC UTILITIES HOLDING COMPANIES

In your statement you mention that the CEO's of three of the largest public utility holding company systems asked you to assign additional staff to these filings. We have also heard from them.

QUESTION:

I note that an additional 2 positions are budgeted for this area, but what is the backlog in public utility regulation now, and what is it projected to be at the end of 1990?

ANSWER:

The backlog of applications in public utility regulation was 34 for FY 1988 and estimates for FY 1989 and FY 1990 are 79 and 139, respectively.

QUESTION:

Am I correct that it would require 7 additional professional staffers and \$600,000 to get and keep current with the public utility workload?

ANSWER:

The Commission believes, based on current projections, that it will require 22 professional staffers at an additional cost over the 14 contained in 1989 of \$500,000 in FY 1990 to get and keep current with the public utility workload.

QUESTION:

The public utility holding companies have indicated a willingness to pay increased fees to cover any additional cost. How should the fee schedule be revised to raise the costs of the additional fees?

ANSWER:

The cost of hiring the additional professional staff could be funded if Congress were to increase the filing fee for form U-1 applications and post-effective amendments from \$2,000 to \$6,000. To stabilize the Commission's public utility activities, the revenues applied to any additional staff should be independent of the specific fees received for the related filing.

QUESTION:

The 1990 President's budget shows that legislation will be proposed to repeal the Public Utility Holding Company Act of 1935. This subcommittee embraced that a few years ago and ran into a fire storm of opposition. What do you think the chances are of making that change now?

ANSWER:

The Commission does not perceive any substantial lessening of opposition to repeal, and therefore does not believe there is a great likelihood of repeal at this time.

SEC FEES AND FINES

QUESTION:

In 1987, more than \$160 million was collected in 1933 Act Fees. These fees declined in 1988 to \$122 million and are expected to decline further in 1989 and 1990. Please explain why these fees are declining.

ANSWER:

The drop of registration fees in 1988 reflects the impact of the October 1987 market break. The fee estimates assume in 1989 and 1990 that a reduction in new sales by investment companies and an increase in the redemptions by investment company shareholders will continue, as it did in 1988, to require less to be paid in registration fees. Most investment companies pay such fees based only on the amount of new sales in excess of redemptions (net sales) during a fiscal year.

QUESTION:

Am I correct that the SEC collects its fees in March based on the actual transactions for the previous calendar year? Why can't these collections be on a monthly pay-as-you-go basis and thereby get the money in the Treasury a little faster?

ANSWER:

Under Section 31 of the 1934 Securities Exchange Act, the Commission collects exchange transaction fees on March 15 following the end of the calendar year on which the volume basis of the fees is calculated. Since the fee is collected by the exchanges at the time each transaction occurs, this provision permits the exchanges to earn interest on the fees they collect for an average of seven months.

At the request of legislative oversight committees, about four years ago the SEC prepared estimates on quarterly collection of transaction fees. My understanding is that the proposal was tabled after the exchanges pointed out that earned interest was used to defer administrative expenses required for the collection, recording, and payment of transaction fees. Within the last two years, GAO also looked at the collection of these fees on a monthly basis. I am unaware of any subsequent action being taken by GAO on this proposal.

COMMISSION WORKLOAD

QUESTION:

In your statement you show that the number of registered broker dealer firms has increased from 6,750 in 1980 to 12,140, and is expected to grow by another 1,360 by 1990. Similarly, the number of registered investment companies has increased from 1,461 to 3,500. With all the mergers in the securities firms, and the October 1987 stock market crash, I would have thought that the number of firms would have decreased. Is this a real increase in the number of firms, or of the SEC's coverage of the firms?

ANSWER:

There has been a real increase since 1980 in the number of broker dealers registering with the Commission. This increase is attributable, in part, to the rapid expansion of the securities markets, including the introduction of new securities products. Additionally, the Government Securities Act of 1986 also has contributed to this increase by requiring the registration and Commission regulation of those firms dealing in government securities, and, more recently bank holding companies have been entering the business through the establishment of separate broker-dealer affiliates.

INVESTMENT MANAGEMENT REGULATION

QUESTION:

Proportionately, the largest staff increase is for Investment Management Regulation, that increases by 51 positions, or 20% over the current level of 255. The justifications indicate that this increase is due to the many new and complex financial products, such as securities backed by diverse types of assets including credit card receivables and car loans, etc.

We are now in the midst of a great crisis in the saving and loan industry. While these securities are not government-backed, it sounds to me like we might be setting ourselves up for another disaster.

Can you find the highly skilled examiners you seek to assure that such products do not pose undue risk to the investing public?

ANSWER:

There is little doubt that now, more than ever before, Investment Management (IM) needs a highly skilled staff to deal with the ever increasing complexity of the products and issues that confront it daily. Although recruitment and hiring of new staff is never easy, if IM receives authority to increase its staff to the level requested in its FY 1990 budget, the biggest problem IM will likely

face is not finding a highly skilled person interested in working at the SEC, but rather finding a highly skilled person willing to accept the salary the SEC can offer. It would be much easier to attract and, equally important, to retain highly skilled persons if the SEC were permitted to offer a salary that is more competitive with that offered by private concerns. At their current level, the salaries the SEC can offer place the agency at a severe disadvantage in the competition for the services of highly skilled persons. Simply put, government salaries have not kept pace with those available in the marketplace and this disparity is further exaggerated in the recruitment of talented and skilled individuals.

However, IM is in critical need of the additional staff it is requesting for FY 1990. Without this staff increase, IM will continue to fall further behind in its efforts to regulate an industry that is expanding in both size and complexity. Recruitment and hiring of the additional staff would be a challenge but one that IM expects to meet successfully.

INTERNATIONALIZATION

QUESTION:

On November 15, 1988, the SEC issued a policy statement on The Regulation of International Securities Markets. What has been the response from international securities regulators to this statement? If the international securities regulators view this policy statement favorably, how will the SEC proceed?

ANSWER:

Last November at the last meeting of the International Organization of Securities Commissions (IOSC), the Commission issued a policy statement on The Regulation of International Securities Markets. The policy statement sets forth principles and goals that the Commission considers to be central to achieving a truly global market system. The response among other market regulators was decidedly positive. The Commission was applauded for taking a leadership role in setting out proposed goals that were sensitive to cultural differences and national sovereignty concerns.

The Commission believes that the first step is to try to achieve some degree of consensus among world regulators on what the policy objectives should be and then on how to accomplish them. Thus, the Commission intends to continue to pursue the goals outlined in the policy statement through international forums such as IOSC. The Commission also believes that much can be achieved through discussions on a bilateral basis with other securities regulators. For example, the Commission recently hosted a

meeting with officials of the Japanese Ministry of Finance, Securities Bureau, to discuss matters of mutual interest.

QUESTION:

The 1990 request includes \$250,000 to allow the Commission to obtain overseas legal counsel to assist in obtaining evidence from foreign countries. We already have FBI legal attaches at many of our embassies. Could they help you in securing the evidence you need?

ANSWER:

In cases where issues arise which involve coordination of evidence gathering with foreign law enforcement officials, the Commission staff may consult with the FBI attaches. However, the Commission also retains foreign lawyers to provide legal advice in cases where we need a foreign attorney who is licensed to practice law in the jurisdiction in question and who thus can appear in foreign court on the Commission's behalf. In such cases, FBI attaches are not qualified to provide the necessary advice or make formal appearances in court.

To be more specific, the Commission retains foreign lawyers to provide advice regarding the application of foreign law to a particular evidence gathering problem or to represent the Commission in a foreign court. For example, when proceeding under the Hague Evidence Convention, the Commission seeks expert legal advice to ensure that the foreign country's legal rules which govern assistance are followed and, in the event legal challenges are posed, that the Commission's position can be effectively presented in that country's courts. In such circumstances it is critical that the Commission's interests be represented by a member of that country's legal community.

QUESTION:

How much does the SEC now spend for international travel?

ANSWER:

In 1988, the SEC spent approximately \$84,000 for 41 trips for international travel. In addition, approximately \$54,000 for 31 trips for international travel was reimbursed to the SEC by host payments.

QUESTION:

Is the SEC moving towards establishing a permanent presence overseas?

ANSWER:

The Commission has created permanent staff positions and/or responsibilities in the area of internationalization. The Commission has assigned staff in each of the Divisions and Offices in the Commission to focus on internationalization issues and, last Fall, issued a policy statement on The Regulation of International Securities Markets, which sets forth principles and goals that the Commission considers to be central to achieving a truly global market system. The Commission believes that the best way to achieve many of the goals outlined in the Policy Statement is through bilateral discussions, rather than multilateral arrangements because multilateral discussions often offer less hope of achieving any true consensus.

The Commission believes that a great deal can be achieved through bilateral discussions with other securities regulators. Examples of successful bilateral initiatives are the Memorandum of Understanding negotiated with the U.K. and the various surveillance information sharing agreements the Commission has encouraged U.S. self-regulatory organizations to enter into with their foreign counterparts (e.g., the draft American Stock Exchange-International Stock Exchange (ISE) surveillance sharing agreement the ISE has described as a "model agreement" and on which the Commission has extensively commented). Another example is the meeting with officials of the Japanese Ministry of Finance, Securities Bureau, (MOF) that the Commission hosted last January to discuss matters of mutual interest. One of the results of that meeting was the formation of a working group comprised of members of the Commission staff and members of the MOF staff. The Commission hopes that this meeting will be the first of many meetings held on a regular basis that will result in a close working relationship between the two agencies.

In addition, the Commission believes that international groups of securities regulators such as the International Organization of Securities Commissions (IOSC), as well as international forums for market participants such as the Group of 30 (focusing on international clearance and settlement issues) provide good opportunities for the Commission to advance its views on how to address many issues internationalization of the securities markets poses.

QUESTION:

Will the \$3,000 requested for the reception and representation fund be sufficient in 1990?

ANSWER:

The \$3,000 will not be adequate to meet the demands created by the Commission's international initiatives that I anticipate in 1990. The Commission is heavily involved

in negotiations and other sensitive forms of interaction with foreign government officials that typically involve business dinners, meetings and other hospitality events. Foreign governments recognize these as important obligations and provide the funds necessary to properly discharge them. Specifically, when the SEC Commissioners and senior staff travel to a foreign country to negotiate agreements, meet on areas of mutual interest or pursue fraudulent activity, they are often invited to a business dinner or a similar social event that furthers the mission. When those foreign officials travel to the U.S. for similar purposes, the SEC should be able to reciprocate, even if it is in a much more modest fashion. By providing a reasonable level of hospitality the SEC would be able to further its leadership position in global securities issues. Even a modest level of hospitality cannot be met within the existing fund's limitation. I recognize the sensitivity of these types of accounts, but feel strongly that the SEC be able to meet fully its international responsibilities.

SEC STAFFING

Mr. Ruder, on page 4 of your formal statement you state that between 1980 and 1988, the Commission's staff grew by less than one percent, from 2,041 staff years to 2,048 staff years. I think for the readers of the record we should include a chart that displays the SEC budget history over the last 10 years.

[The chart follows.]

SEC BUDGET HISTORY FROM 1980 THROUGH 1990

<u>YEAR</u>	<u>CONGRESSIONAL BUDGET REQUEST</u>			<u>APPROPRIATION</u>			<u>ACTUAL</u>		
	<u>POS.</u>	<u>FULL TIME PERMANENT STAFF YRS</u>	<u>TOTAL STAFF YRS</u>	<u>POS.</u>	<u>FULL TIME PERMANENT STAFF YRS</u>	<u>TOTAL STAFF YRS</u>	<u>POS.</u>	<u>FULL TIME PERMANENT STAFF YRS</u>	<u>TOTAL STAFF YRS</u>
1980	2,100	1,991	2,016	2,100	1,999	2,035	2,100	2,009	2,041
1981	2,105	2,005	2,041	2,021	1,970	2,006	2,021	1,960	1,982
1982	2,141	2,023	2,059	2,021	1,890	1,920	2,021	1,864	1,882
1983	1,896	1,765	1,795	2,021	1,892	1,912	2,021	1,899	1,921
1984	1,896	1,775	1,795	2,021	1,881	1,901	2,021	1,863	1,885
1985	2,042	1,913	1,933	2,046	1,916	1,936	2,046	1,914	1,940
1986	2,046	1,916	1,936	2,080	1,914	1,934	2,080	1,871	1,898
1987	2,086	1,973	1,993	2,086	1,930	1,950	2,086	1,896	1,930
1988	2,267	2,066	2,086	2,267	2,066	2,086	2,267	2,009	2,048
1989	2,420	2,222	2,242	2,267	2,111	2,131			
1990	2,451	2,249	2,269						

QUESTION:

Am I not correct that in fiscal years 1983 and 1984 the administration proposed staff reductions below the number Congress provided?

ANSWER:

Yes, the administration proposed staff reductions below the number Congress provided in fiscal years 1983 and 1984.

QUESTION:

The Commission's budget includes a base adjustment of \$2.5 million to increase journeyman and entry grade salaries. What problems is the SEC experiencing as it had been a common view that an SEC appointment was eagerly sought by those looking for a career in the securities industry?

ANSWER:

In 1988, the Commission's turnover rate for specific positions was as follows: secretaries, 35%, computer specialists, 19%, attorneys, 15%, accountants, 14%, and securities compliance examiners, 13%. Unfortunately, last year was not an aberration -the agency has been combating elevated turnover rates for more than seven years.

Attorneys who leave the SEC typically receive annual salary increases between \$25,000 and \$35,000. Accountants who leave the SEC typically receive annual salary increases between \$13,000 and \$35,000. Securities Compliance Examiners typically receive \$25,000 to \$45,000 annual salary increases when they leave the SEC. When those ranges of salary increases are multiplied by the 1988 losses for each occupation, the result is, that departing SEC professionals received annual salary increases between \$3,535,000 and \$5,515,000. The requested \$2,484,000 will not produce parity. However, it could significantly reduce the excessive turnover while providing greater program continuity and productivity.

While the Commission does attract many qualified professionals eager for careers in the securities industry, we, like other agencies, find it increasingly difficult to attract them in sufficient numbers. Moreover, the Commission is not the only viable career alternative as many recent graduates are hired by the industry at salaries significantly higher than the Commission is allowed by law to pay.

QUESTION:

What is the status of the SEC's implementation of the Inspector General Act of 1988 that requires the agency to establish an Office of the Inspector General?

ANSWER:

In order to meet the requirements of the 1988 amendments to the Inspector General Act, the Commission will provide a substantial increase in resources from the current 4 staff years to 7 staff years in 1990. Total expenditures for the Inspector General (IG) are estimated at \$470,000 in fiscal 1990.

The SEC is complying fully with both the letter and the intent of the statutory requirements. On February 15, 1989, Walter Stachnick was appointed as the SEC's Inspector General. Prior to this appointment, Mr. Stachnik has been the agency's Director of Internal Audit. Implementation plans for this new function have been carefully developed and the transition is proceeding smoothly. The support offices and the General Counsel will assist the IG through formal procedures established in memoranda of understanding. Using this approach, the IG will be able to preserve its autonomy without having to duplicate support services.

QUESTION SUBMITTED BY SENATOR WARREN RUDMAN**SEC BUDGET**

This Committee has tried to be as supportive as possible of SEC funding requests in the face of very stringent budget constraints. In 1989 most of the agencies in the Senate bill were held to a 1% increase over 1988. However, Senator Hollings and I agreed that ten high-priority programs should be exempt from this ceiling, and so we included an increase of 11% for the Securities and Exchange Commission. Unfortunately this could not be sustained in conference with the House, but we did emerge with an increase of 5.4%.

QUESTION:

For 1990 the Commission is requesting an increase of \$26 million or 18.3%. Again, Senator Hollings and I want to be supportive of your budget and will do our best to meet your request. We do understand, however, that you have experienced \$5 million in savings in the operational contract for your new electronic filing system, EDGAR. Therefore, can we reduce your budget request by \$5 million and still provide the Commission with the programmatic resources it needs consistent with its budget?

ANSWER:

No. The SEC requires its full request of \$168.7 million to cover unfunded costs detailed below.

	\$(mil)
Unfunded costs-	
Balance of January	
1989 pay raise	3.7
Office space requirements (NYRO, IARO and HQ)	.4
Reduce SEC lapse rate by 18 staff years to 7.5%	.9

	5.0
	=====

Should the \$3.7 million for the January 1989 pay raise not be provided, the SEC would suffer a programmatic reduction of approximately 80 staff years. This reduction would be experienced across all the program activities.

SUBCOMMITTEE RECESS

Senator HOLLINGS. Thank you very much, Mr. Chairman, you and your associates today. This concludes our hearing. The subcommittee will be recessed until next Tuesday, April 11 at 9:30 when we will hear the request of the Board of International Broadcasting and the U.S. Information Agency.

[Whereupon, at 11:20 a.m., Thursday, April 6, the subcommittee was recessed, to reconvene at 9:30 a.m., Tuesday, April 11.]