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I had not planned to talk about capital markets this morning. I had a somewhat more pedestrian topic in mind. But when I arrived yesterday afternoon I heard much discussion about John Whitehead's remarks, and John was nice enough to give me a copy of his talk for bedtime reading. Because of the transcendent importance of John's subject and my immense respect for his experience and views, it seems appropriate to spend awhile on the same subject and curtail my remarks on other matters.

There is no question at all in my mind that we should all be deeply concerned with the apparent capital needs of the American economy for the foreseeable future. At the moment all vital signs seem bad. However, in keeping with my Midwestern tradition of being less panic-prone than Wall Street, I must confess that I am not quite as alarmed as John.

I first encountered this business of projecting capital needs and matching them against available sources last fall when an officer of a major New York bank wrote a report on the subject. It was not optimistic. Then another prominent New York bank officer gave some well-publicized talks to the effect that energy alone would require $1.3 trillion to be raised over the next ten years, which would require an average return of some 18% on invested capital. Other estimates have now come to General Electric's guess of $3.3 trillion over ten years, or $300 billion a year.

In watching this numbers game, one is tempted to observe that the first liar hasn't a chance, but that is flip and unfair. I do not suspect anyone engaged in the exercise of projecting our future capital requirements of being other than perfectly sincere -- certainly not of lying. But having observed all of the other projections of disaster that have not come true in my lifetime does make me somewhat hesitant about the degree of alarm called for.

We have had so many of them. When I was in the third grade one of those weekly newspapers for school kids reported that we had only a twenty-year supply of oil -- so, at the age of eight, I lay awake worrying about the dismal prospect of our running out of gasoline shortly after I became of age to drive and wondering whether we could make fuel out of corn stalks -- a commodity in abundant supply in Illinois. At the Chicago World's Fair in 1933, the Census Bureau had an exhibit which reported the estimated population of the United States every minute. It was more or less 120 million at the time. At the age of 13 I was gratified to see the number decreasing, if every so slightly, because everyone knew in those days that we had too many people. With the closing of the Western frontier we had become a static society, and population had to at least stabilize.

So with the post World War II population explosion, and our now unfilled schoolrooms and few jobs for teachers. So with the dread threat of competition from cheap labor and German and Japanese automobile manufacturers now seeking sites for production facilities in the U.S.

Jim Fullerton, currently Chairman of the Investment Company Institute, told a wonderful story about economic projections recently. He was quoting an author, and I wish I could remember his name to give him proper credit. Anyway, this man went back to 1850 and, based upon available data and trend lines, sought to project the future production of horses and chewing tobacco. From these data it was quite clear that by now Washington would be awash in tobacco juice while New York City would be covered all over with 300 feet of horse manure.

One exercise that might be enlightening would be to go back, say, to 1950, and see whether anyone at that time could have estimated the fantastic sums of capital that in fact were raised in the next twenty years and could have plotted where these sums were going to come from. I doubt it.

Yesterday I read with much interest Irving Kristol's piece in the Wall Street Journal about economic growth rate and inflation. It was his thesis that the projection of 6% plus annual growth in the GNP was quite unrealistic and the efforts to force feed it for that end were inevitably inflationary. Similarly, he argues that bold efforts by business managers to achieve 10% plus annual growth in earnings cannot succeed across the board, even if selected companies can make it, and that the investing public at large simply no longer believes these projections.

But all of this smart aleck talk is pretty unfair. John doesn't know, any more than I do or General Electric does, whether $3.3 trillion is a realistic figure, but one must not scoff at the effort to look ahead and see whether apparent resources seem adequate to meet apparent needs. Whoever engages in that exercise today, whatever numbers he uses, comes to the same conclusion. The apparent resources do not meet the apparent demand. And, as Senor Albors explained yesterday morning, if the demand is great enough, where private capital fails, government will move in.

There is unquestionably today every reason to be deeply concerned about where private industry is going to find adequate equity capital from non-governmental sources. Even if one accepts the idea that low P-E ratios may be with us for a long time, it is alarming when investment bankers report that, even at five times earnings, they can't find any buyers.

Just recently, a well-regarded electric utility company put an issue of preferred stock up for competitive bidding. They received only one bid -- for a cost of money of 12½%. Even that was called off when they discovered a serious problem in a nuclear generating facility. I realize that electric utilities, and preferred stock, and competitive bidding are all special features. Nevertheless, such an event is alarming.

So, too, is the erosion of capital from the investment banking industry. John probably could have painted a blacker picture in this regard than he did. Not only has the aggregate capital invested in the entire securities industry declined, there are threats of more personal capital being withdrawn, and the industry currently is looking in vain for any new sources of capital. Certainly the outlook is dismal in this regard unless the industry can offer the prospect of reasonable earnings.

So, while I have some reservations about the dimensions of the future, and am perhaps somewhat less alarmed than John, it is not because I have access to any better information. It is probably just a more placid approach to life, as befits the differences in our physiques. I agree with him thoroughly that the vital signs are presently all bad, and we should be and are concerned about them. I agree with him thoroughly that healthy capital markets are good for the country and that a healthy, prosperous securities industry is good for the country. If John will tell me what the SEC can do to get interest rates down, cool off inflation, restore the interest of individuals in our markets, and attract new capital to Wall Street, all of us at the Commission are eager to hear about it.

At the risk of sounding carping and overly-defensive, let me mention a few other matters. We are, for example, generally of the view that our tax laws discourage equity investments by individuals and inhibit members of the securities industry from retaining earnings to increase capital, especially relative to banks and savings and loans.

But we are part of the federal government, and we must move quietly and with due regard to the primary responsibility of other branches of government as to tax policy. We are not disposed to take kindly public statements by other branches of government about how we run our business, and we must expect reciprocity. We are, however, consulting with Treasury in this area, looking forward to the next Congress. No one has asked us to comment on any of the pending legislation in this Congress.

I really have nothing to say about the staff requesting additional information for a 189-page prospectus. I trust the request was reasonable, and, of course, I don't know what was in those other 189 pages. As for John's foreign client who didn't want to meet our standards for a public offering in this country without at least a 1 percent favorable differential in cost of money, what should we do? We do make some accommodations for foreign issuers based on local customs or political problems, but on the whole, we don't think they should be given a pass just because they are foreign and don't like our standards. I wonder how many people think we should.

Of course, if you think we require too much of a Mickey Mouse nature from domestic issuers to begin with, you may have a point in some areas, but that's different from urging some sort of foreign preference.

As for our enforcement methods, there are certainly members of the securities industry who think we injure it relative to competitors, especially banks, by the publicity given to our actions. The argument really should be that we should use more private, informal methods rather than go to court, because there is no way to make a lawsuit private and the publicity we give to lawsuits is very sober and factual. But I hear even more people tell me that public enforcement actions are in the end, and on the whole, beneficial to the total system -- assuming we have reasonable grounds for our actions.

In any event, there was no way to keep the demise of Weis Securities private, any more than you can privately close a bank, and we said very little publicly about the whole duPont Walston liquidation. In fact, two senior members of our staff spent all of one weekend in New York working with the New York Stock Exchange people and the firms involved to facilitate the orderly disposition of the duPont Walston business. The only public statement that I made on the whole affair was that, according to our information, no customers were in danger of losing any funds or securities. That seems to me rather similar to what the bank regulatory agencies did in the Franklin National Bank situation -- except that duPont Walston did not have an office engaged in unauthorized foreign currency transactions costing a still undetermined number of millions.

As for advertising, you might want to discuss this with Neil McCoy later this morning. There is a significant statutory difference between a tombstone announcing an underwritten distribution and other advertising that is governed only by fraud rules. Banks are not exempt from the fraud rules. There may be an unreasonable and unfair discrepancy here that should be looked into.

As for cultivating more interest in your own stock, assuming you are not engaged in or planning a public offering, I would like to think about that a little more. But John's suggestion that you analyze your stockholders and why they come and go raises questions about stockholder identification and communication that is germane to something else I want to talk about.

The development of the federal securities laws has, with the exception of the last few years, been primarily concerned with the distribution of corporate securities to the public and the fairness of the markets in which those securities can be traded. For far too many years, far too little attention was paid to the nature of corporate investors, the mechanics by which ownership of securities is acquired or transferred, and the nature and size of securities transactions. This organization, of course, has been at the forefront of the recent concern with this rather broad topic.

As you know, these are matters of no small import. The formalities by which persons may transfer their securities, the names in which securities are held and the identity and nature of the persons buying, selling and holding those securities have an important bearing on the day-to-day management of your companies and the ability of your companies, in the future, to seek again to raise capital from the investing public by the issuance of equity securities.

Much has been said in the public press, and in congressional committee hearings and reports, about the detrimental features of the recent growth in institutional investment and concentration of money management. Some persons are concerned about it from an antitrust point of view, fearing the excessive concentration of power through portfolio management, especially when combined with other financial resources.

According to figures recently published by the Senate Committee on Government Operations, at least 28 institutions are known to manage investment portfolios in excess of $5 billion each, or a total of almost $310 billion. The decisions of these institutions can affect the stability of the securities markets and can have significant impacts on individual companies as well.

I think we are all familiar with the complaints that have been raised about this situation. Institutional investors are accused of concentrating their investments in a relative handful of stocks, with the result that these are grossly overpriced, while other issues are neglected. In this process they are said to have dried up sources of equity capital for many businesses, especially smaller ones, and depressed the prices of other stocks so that the raising of new equity capital is unattractive, if not impossible. Institutional money managers are accused of possessing in marked degree a herd instinct, which causes them all to move in and out of the same stocks at approximately the same time, so that when one sells, the others quickly follow, causing the price of a stock to decline sharply and individual investors to find themselves suffering severe losses without any change in the fundamental factors of a given stock, and even worse, of having this occur quickly before individuals have news and can act. Institutional investors are also accused of having better, and possibly illegitimate, sources of inside information not made available to the ordinary investor. And concern has been expressed about the use of nominee accounts by investors and its effect on a corporation's ability to communicate directly with its beneficial shareholders. Some even suggest that the activities of institutional investors, among other factors, have caused many smaller and medium-sized U.S. corporations to become prime targets of foreign take-over bids.

I am not prepared to say that all of these complaints are without any foundation, but I think it is a mistake, at least from a governmental point of view, to approach institutional investors individually or collectively as bad guys to be punished. Maintaining the liquidity of these institutional portfolios and their ability to meet their obligations is of major social, as well as economic, importance. However, these complaints do point, in many respects, to serious problems, and, while there is, as yet, no consensus concerning whether any government controls should be placed on securities trading and holdings of institutional investors, it is clear that the Congress, the Commission, and the public will be unable intelligently to address the questions that have been raised without a better data base than presently is available.

One measure for obtaining information with respect to securities transactions and holdings of institutional investors, which I believe has generally been supported by spokesmen for institutional investors, is an Institutional Disclosure Act. At the request of Senator Williams, we prepared and submitted a bill that would amend Section 13 of the Securities Exchange Act of 1934 to require investment managers of large portfolios to make periodic disclosures of the contents of their portfolios, and at least their larger transactions during specified reporting periods. A similar bill has been introduced in the House by Congressman Moss.

We approach this matter in terms of the investment manager and the aggregate funds subject to his management, rather than in terms of individual portfolio size. This seems to be the relevant consideration for the significance of the information to be extracted.

As to what that minimum size should be, so as to trigger the requirements of the bill, we have suggested initially an aggregate fair market value in equity securities of at least $100 million, with authority in the Commission to reduce that to an amount not less than $10 million. At

$100 million, we estimate that we will receive reports from approximately 300 investment managers responsible for about 75 percent of total institutional stockholdings. If the sum went down to $10 million, the number of investment managers reporting would be several thousand, according to our data, but the percentage of institutional stockholdings would only be about 85 percent. At the moment, initially at least, we do not want to receive several thousand reports of this sort. We wouldn't have the facilities to do anything meaningful with that number of reports, and I doubt that the public would have sufficient interest at that level to justify it. If the program gets going and proceeds well, and we do find useful things to do with the reports, we may consider moving down below $100 million.

The bill would permit the Commission to require reports as frequently as it sees fit, but not more often than monthly. Transactions that involved more than $500,000, or such other amount as the Commission may by rule determine, would have to be reported. For the purpose of these bills, the term "investment manager" includes any bank or bank holding company or subsidiary thereof, any insurance company or insurance holding company or subsidiary, any investment company, any broker-dealer, or any other investment adviser as defined in the Investment Advisers Act of 1940, and certain other persons. To protect the confidentiality of trust relationships with individuals, we have suggested a proviso that information identifying the holdings of equity securities of any natural person, trust or estate, other than a business trust, which is filed with the Commission pursuant to this bill, shall be confidential.

If an institutional disclosure bill were adopted, a doubtful prospect at the moment in light of other Congressional preoccupations, it would not only prove valuable to the investing public, for reasons that I believe should be self-evident, but it would also assist corporate officers in determining who held their company's stock in any given period and the concentration of such holdings.

More recently, the Comptroller of the Currency has proposed amendments to the regulations governing the fiduciary powers of national banks for the stated purpose of providing "the public [with] as much information concerning bank trust department asset holdings and transactions as is consistent with the protection of the confidentiality of individual holdings and investment strategies." The Comptroller's regulations would require national banks having trust departments of a significant size -- in most instances, those having total assets with an aggregate fair market value of $100 million or more -- to file annual reports with the Comptroller disclosing their assets, including, of course, equity securities, and to file quarterly reports disclosing significant transactions in any of their equity security holdings. But the information filed would not be made available to the public if the reporting bank requested that it be kept confidential, unless the Comptroller determined such public disclosure to be in the public interest <u>and</u> consistent with other provisions of the regulation.

Quarterly transaction reports would be required with respect to any purchase or sale of any equity security having a fair market value of $500,000 or more, or involving 10,000 shares or more, effected for any fiduciary account or accounts over which the bank has either sole or shared investment authority.

To the extent that the Comptroller's proposal would make public certain information with respect to the securities transactions and holdings of the trust departments of national banks, it is, in my view, a constructive step forward. But, the usefulness of this information as a factual basis for the development of appropriate regulatory policy will be limited unless and until legislation designed to provide the Commission <u>and</u> the public with comparable information concerning the investment activities of <u>all</u> major institutions, including national banks, is enacted. In any event, I believe that the Comptroller's proposed regulations are further evidence of the growing recognition, by both the government and the private sector, of the need for more information about the investment activities of institutions.

Any of you that followed the newspapers last summer are well aware of the fact that Senator Bentsen held hearings before his subcommittee exploring the possibility of some further restrictions upon institutional portfolio activity. The ideas that received the most attention are those that would limit the concentration of portfolios in particular securities, and those that would limit the amount of selling of any given security over a specified period of time. Senator Bentsen himself rather early concluded that the latter idea was not promising, but he did take favorably to the former idea. In late December, he submitted a bill, which still is pending in Congress, that would impose a diversification requirement, at least upon pension funds. The bill is in the form of a tax provision, imposing unfavorable tax consequences upon a fund that did not meet its standards. The bill applies only to pension funds, and not to other institutional investors, and the percentage limitations in the bill apply to the aggregate assets of all pension funds which are under common management, rather than to the assets of individual funds.

The aggregate pension funds under common management, according to this bill, cannot have more than five percent of their total assets invested in any one stock, nor can they hold more than ten percent of the outstanding shares of any one company. Many of you will recognize this as the diversification standard imposed by the Investment Company Act of 1940 upon investment companies wishing to hold themselves out as "diversified," and also by the Internal Revenue Code for investment companies that wish to be taxed as "regulated investment companies", except that Senator Bentsen's bill would apply across the board.

His bill also includes a provision exempting up to one percent of a pension fund's assets from the prudent man rule, to permit their investment in the securities of smaller issuers. This is stated to be for the purpose of encouraging pension fund money managers to invest in small companies, particularly to invest in underwritten offerings of new equities.

We have not been asked to testify or comment upon this bill to date, nor has the Commission attempted to develop an official position with respect to these provisions. Speaking only for myself, I am not opposed in principle to some legal restrictions or requirements with respect to the composition of pension fund portfolios, although to the extent that the proposed restriction has a "legal investment" purpose unrelated to market effect, it is probably none of our official business. But I doubt whether Senator Bentsen's bill will have a very significant effect upon the market and I believe he shares that doubt. Most corporate trust officers who testified last summer indicated that, in their own departments, they had a working rule of thumb of five percent anyhow, and the bill would not only grandfather existing portfolios, but exempt disproportions that came about through changes in market values. Furthermore, of course, five percent can be quite enough stock in a large listed company so that its sale may be cumbersome and, if not done wisely, have an adverse affect upon the market price of the stock generally.

None of the pending legislation -- neither the Moss, Bentsen nor Williams bills -- however, directly redress the lack of disclosure of the identity of persons who are entitled to vote securities held in street or nominee name.

The closest they come are the provisions in S. 2058, which passed the Senate in August, 1973, or H.R. 5050, which is presently pending in the House of Representatives. If these are enacted, the SEC will be directed to study the practice of registration of securities other than in the name of the beneficial owner to determine, first, whether such registration is consistent with the policies and purposes of the Securities Exchange Act, and if so, whether steps can be taken to facilitate communications between corporations and their shareholders, and yet at the same time, retain the benefits of such registration.

At present, we receive information with respect to large security holdings from two principal sources: the reporting company itself and certain of its shareholders. To refresh your recollection, an issuer, in both its Form 10-K and its proxy statement, is required, among other things, to identify any person who is a recordholder, or is known to be a beneficial owner, of more than 10 percent of any class of the company's voting securities, the amount of securities he owns, the percentage of the class such amount represents, and the type of ownership he has with respect to those holdings. Information concerning the stock holdings of directors is found in proxy statements when shareholders are electing directors.

And, of course, there are the requirements of Section

16(a) of the Securities Exchange Act for reports on Forms 3 and 4 by directors and officers and ten percent shareholders.

Certain other shareholders are also under a duty to report specific information about their holdings. The Williams Act provides for disclosures by persons making acquisitions of securities and by persons proposing to make tender offers, and Section 13(d) of the Securities Exchange Act requires any person, or group of persons, acquiring beneficial ownership of more than five percent of a class of registered equity securities, to file with the Commission certain specified information, including the names of the purchasers.

Although some information with respect to five percent beneficial owners is now provided to the Commission and to the company under Section 13(d) of the Exchange Act, and to the company's stockholders in the event of a tender offer subject to Section 14(d) of that Act, the Commission has never required reporting companies to disclose this information in filings under the Securities Exchange Act, but our staff is currently considering such a proposal.

While these provisions in the Acts and rules are aimed, among other things, at informing investors where the major blocks of stock are held, and alerting management, as well as the public when someone, or some group, has moved into a significant stock ownership position, they fall short of curing the frustration of management in wanting to know who owns the company and being able to communicate with them directly, and they don't tell either public investors or the government all they would like to know about who owns American corporations.

Many people smiled a bit years ago when an administrative law judge ordered some railraods to reveal their 10 largest shareholders, knowing what the lists would probably look like and how uninformative they would probably be. And many of us laughed when a well-known consumer came out with a public blast demanding that the Antitrust Division look into the shocking fact that Cede & Co. seemed to control our major airlines. But the problem is not a funny one, and I don't think Congressional interest is going to disappear in the new Congress.

Last December, there was published a joint report on disclosure of corporate ownership by two subcommittees of the Senate Committee on Government Operations. Among other things, it urged the SEC to require the regular disclosure by '34 Act reporting companies of their 30 largest shareholders. Last May 21, the Commission testified before Senator Metcalf, Chairman of one of those subcommittees. Commissioner Sommer did the testifying. After explaining our present statutes and rules, Mr. Sommer went on to describe some possibilities that we are studying, in the absence of any legislation, and in addition to the "30 largest shareholder idea."

Under the present statutory framework, the Commission's direct authority to compel disclosures by shareholders themselves is contained in Sections 13(d) and 16(a) of the Securities Exchange Act of 1934, and that power is limited to compelling disclosure of "beneficial ownership." In all other respects, the Commission must apply its disclosure requirements to issuers, who often do not know where the voting power is located; the only certain information they have is information concerning record ownership, and that, of course, does not necessarily identify voting power.

We could compel issuers to disclose voting power information to the extent it is known to them, but it is unlikely this would yield much reliable data. We could, of course, require broker-dealers to furnish the issuer with the names of their customers for whom they hold shares, but, in the absence of any authority to compel other nominees to do the same, I think we must resist the temptation to single out the brokerage industry.

If the Commission adopted a redefinition of the term "beneficial ownership" within the context of Sections 13(d) and 16(a), to include the possession of voting power, then the holders of the power to vote five percent or more of a class of registered equity securities of a '34 Act company would in many instances, and the holders of more than ten percent would in all instances, be required to report this information directly to the Commission, the exchanges upon which the securities were listed, and, in the case of Section 13(d), the issuer. The Commission could then require the inclusion of this information in filings with the Commission and in proxy statements circulated to shareholders.

Our staff also is examining practices with regard to the identification of institutional investor nominees as shareholders under our present disclosure requirements. Disclosure of a nominee's name without an identification of the institution using that designation is of little benefit to anyone and I believe we should strengthen the practice of compelling issuers who file documents with us to identify the economic entity underlying a nominee name when it is reasonably available to them. In some cases, that information is not readily available, although with respect to virtually all significant nominees, the coupling of nominee names and the principals is readily apparent from examining the manual prepared by your organization. Our power to compel institutional investors to furnish such information to issuers may be limited and, therefore, we may have to rely for the most part on the ability of issuers to gain this information. One trouble with this, naturally, is that it may not tell anyone very much. When you go from Cede & Co. to X & Co. to Y Bank and Trust Company, you are presumably getting closer to the persons that control the stock, but you certainly are not there.

While you may see some proposals from us in this direction in the coming year, they will probably irritate you more than help you. No real breakthrough can occur unless the issuer has the legal right to demand the identities of the people who have the power to vote their shares, or the persons who hold shares without the power to vote are otherwise compelled to publish or file this information. There is no pending proposal that goes that far.