NEWS

SECURITIES AND EXCHANGE COMMISSION
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REMARKS TO

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STATESBORO, GEORGIA

APRIL 7, 1983

"SOME HISTORY"

The views expressed herein are those of Commissioner Treadway and do not necessarily represent those of the Commission, other Commissioners, or the staff.

I. SOME HISTORY

The Commission will shortly celebrate its 50th Anniversary. Its history too lengthy to cover in detail, but I would like to make some historical observations before discussing more current matters.

The primary objectives of the Commission are the protection of investors and the maintenance of fair, orderly and efficient securities markets. The Congressionally-mandated emphases arise from two main causes. First, the frenzy of the 1920's, the Stock Market Crash of 1929, the Depression demonstrated a need for such protections. Second, in most countries securities trading is principally the province of securities professionals. But in the U.S. more than 130,000,000 Americans own stock. Most are ordinary people, not financial experts, and they need protection.

The Commission goes about its business in several ways. Securities exchanges and securities professionals are subject to considerable internal regulation and oversight. But the treatment of business corporations is different. The Commission does not regulate the internal corporate affairs. Rather, the requirement is full and fair disclosure of material facts. Such reporting requirements are a discipline, but are much less obtrusive than direct regulation.

Significant changes over the years have occurred in the Commission's relationship with the stock exchanges. In the early years, the relationship was rather stormy. More recently, particularly since 1975 when Congress revised the Securities Exchange Act to give the Commission additional authority, the relationship has changed. The Commission relies to a considerable extent on the exchanges to regulate their members with the Commission engaging in active oversight with respect to self-regulation of the securities industry.

The over-the-counter market has a slightly different history. In 1939 the over-the-counter companies created an organization known as National Association of Securities Dealers, Inc. From a small beginning, this organization developed into an effective and successful instrument for self-regulation, with active Commission oversight.

Self-regulation under government oversight has come to work quite well. Given limited staff and resources, the

Commission would never have been able to do the job effectively without self-regulation. The Commission, I should point out, is one of the smallest agencies of the government, having less than 2000 employees nationwide and a present annual budget of about $85 million.

II. RECENT DEVELOPMENTS - DEREGULATION

Having outlined some history, let's turn to current events. A major expansion of economic regulation occurred in the past thirty years. This has involved substantive control over business operations. Such regulation carries a cost, and it is argued that the cost in some instances outweighs the public benefits. Thus, the deregulatory effort.

Deregulation is an important development for our country and can be beneficial. But the balance between over-regulation and inadequate regulation is difficult to achieve. It is important to remember, however, that the primary statutory mandate of the Commission is to protect investors and to maintain honesty and integrity in the securities markets. Notwithstanding the deregulatory efforts, the Commission is primarily an enforcement agency charged with protecting investors and maintaining the honesty and integrity of the securities markets. Let's look now at some of the principal areas of deregulation at the Commission. Three dominant deregulatory themes have evolved within the Commission:

1. Streamline and simplify regulations to eliminate unnecessary rules and reduce the complexity of those that remain.

2. Increase reliance on the private sector.

3. Remove unwarranted barriers to the operation of the free market.

III. Current Major Items

1. Swiss Accord

The Commission's investigations of Federal securities law violations - particularly insider trading - have sometimes been impeded by foreign secrecy laws or blocking statutes. In August 1982, Switzerland and the United States concluded long negotiations by signing a Memorandum of Understanding concerning law enforcement cooperation in insider trading cases. The Memorandum contains understandings with respect

to an agreement between members of the Swiss Bankers Association, which will permit Swiss banks, under certain circumstances, to furnish information and evidence to the Commission through the Swiss Federal Office for Police Matters, notwithstanding Swiss secrecy laws. The implementation of this Accord continues. This Accord removes a major barrier to prosecution and may well set a precendent for similar agreements with other bank secrecy countries and accords in other areas of law enforcement.

2. CFTC Accord.

Last year, the Commission concluded an accord with the Commodity Futures Trading Commission, which resolved a troublesome jurisdictional dispute between the two agencies. The 1978 amendments to the Commodity Futures Trading Act had produced confusion about whether the SEC or the CFTC had jurisdiction over the trading of certain proposed new financial instruments, such as options on U.S. Treasury securities. This confusion and resulting litigation were a major impediment to the initiation of trading in these instruments. The Accord, which implemented an agreement between the two agencies resolving the dispute, was enacted into legislation by Congress last Fall. Since passage of the legislation, each agency has approved trading in a substantial number of new financial instruments. Perhaps the most unusual or interesting of these new instruments have been options and futures on stock indices, and options on foreign currencies.

3. Shelf-Registration of Securities - Rule 415

Traditionally, corporations have registered a new securities offering and, following the Commission's declaring that registration effective, sold the entire offering through underwriters to investors at one time. However, temporary Rule 415 has permitted the practice of registering securities and holding them on the "shelf" to await favorable interest rates or market conditions, at which time all or a portion of the offering is brought to market immediately. Although such "shelf registrations" have been used in the past in certain limited areas, Rule 415 has extended the practice to traditional primary offerings. Rule 415 is temporary, effective only through December 1983, at which time the Commission must re-examine its utility. Because Rule 415 substantially changes the normal practice by which underwriters investigate new securities offerings, shelf-registrations of equity securities have proved somewhat controversial.

4. Insider Trading Sanctions Act.

Trading securities on the basis of material, non-public information, "inside information", is illegal and a major enforcement emphasis. The Commission recently sent to Congress a legislative proposal to impose new, tougher sanctions on persons who trade on inside information. Under the current law, someone caught trading on the basis of inside information is merely required to forego his profits. The new legislation would permit the Commission to seek civil monetary penalties of up to 300% of the insider's profits.

5. Tender Offer Study

In the past two years, there have been a number of billion-dollar partial tender offers, which have led to renewed public interest in the regulation of tender offers. The Allied-Bendix-Martin Marietta struggle is perhaps the best-known example. The Commission has taken two actions to respond to these developments. First is the technical matter of extending the proration period in partial tender offers to provide stockholders a better opportunity to make informed investment decisions. Second, the Commission recently formed an Advisory Committee on Tender Offers, composed of sixteen most distinguished and experienced participants, who will examine tender offer practices and make recommendations for changes in the current regulatory scheme no later than July 1983. In particular, the Committee will consider whether additional protections are required for the shareholders of both the target and the bidding companies.

6. Proxy Study

The Commission has begun a comprehensive review of the disclosure and procedural rules governing the proxy solicitation process. This review will consist of six major programs:

1. A revision of the disclosure of management renumeration, particularly corporate perquisites;

2. A revision of the disclosure of corporate transactions with management and certain related persons;

3. A re-examination of the rules governing shareholder proposals;

4. Simplification of the merger proxy statement to eliminate needless length and complexity;

5. Review of the rules governing proxy contests; and

6. An evaluation of the recommendations of the Advisory Committee on Shareholder Communications concerning the process by which issuers communicate with the beneficial owners of their securities.

The first project in this review was completed in December with the adoption of new rules for the disclosure of transactions with management and the relationships of management to significant customers, suppliers, and others. The Commission has published specific proposals for changes in the rules for shareholder proposals, shareholder communications, and the disclosure of management renumeration. Finally, in the past month, the Commission has begun work on the simplification of the merger proxy statement and the review of the rules governing proxy contests.

7. Investment Companies

The Commission recently published a proposal for changes in the management of investment companies. The Commission has sought public comment on whether it should seek legislation or propose rules to permit certain types of mutual funds to be organized and operated without shareholder voting or boards of directors. Some industry observers have argued that the withdrawal of funds by dissatisfied investors is a far more effective management discipline than that voted by proxy statements. It is thought that this proposed type of investment company, called a unitary investment fund, would be particularly suitable to money market funds, which compete with banks, savings and loans, and other financial institutions, which are similarly organized. Unitary investment funds would be structurally similar to bank-managed common trust funds, insurance company separate accounts, and investment trusts which operate without apparent problems in most of the rest of the world.

8. Securities Activities of Banks

A year ago no banks provided discount brokerage service;

today over 600 do so. This rapid expansion of securities activities of banks is leading to substantial changes in the structure of the brokerage industry. The Commission's involvement in this process has been peripheral, but it is leading to the progressive involvement of the Commission in the activities of depository institutions, an area traditionally assigned to Federal and State banking regulators.

IV. ENFORCEMENT PROGRAM

An essential companion to the Commission's deregulation effort is our enforcement program. Although much is said about the Commission's regulatory efforts, the Commission fundamentally is a law enforcement agency. Enforcement is the largest single segment of the Commission's activities, consuming approximately one-third of our budget and staff.

I would like to mention briefly some of the major areas of continuing concern to the Commission's enforcement effort.

1. The first area deals with the sales practices and conduct of broker-dealer employees. Broker-dealers occupy a vital position in the securities markets because they serve as a sole means of access to those markets for ordinary investors. In recognition of this important role, the Securities Exchange Act imposes on broker-dealers a responsibility to supervise the conduct of its employees. The Commission brings actions against both employees for violations of the Federal securities laws and against their employing firms for failure to supervise the activities of their employees with a view toward to preventing those violations. Effective supervision by broker-dealer firms is essential to the protection of investors and the maintenance of fair and orderly markets.

2. A second enforcement area is financial statement fraud -- colorfully known as "cooked books -- by reporting companies. These cases generally involve outright falsification of books and records through a variety of schemes, such as prerecognition of sales revenue, falsification of inventory records, and the fictitious invoicing of customers or the fraudulent billing of the company by suppliers, sometimes with their cooperation. I personally believe that financial statement fraud does more to undermine the public's confidence in the fairness and integrity of the securities markets than any other simple activity. The entire Federal regulatory scheme is premised upon the full and accurate disclosure of

material information about issuers. The reliability of corporate financial statements is therefore essential.

3. The third area is insider trading. As I mentioned, the Commission has submitted a legislative proposal to Congress that would authorize harsher sanctions against those who engage in insider trading. But deterrence of such activity in the end depends on an effective and vigorous enforcement program. In the last year, the Commission brought 20 such insider trading cases and it will continue an active program in this area in the coming year.

4. The fourth area is market integrity. In the past year the Commission brought 31 cases dealing with market manipulation and other violations of market integrity.

5. In the last major area, securities play mostly an incidental role. I'm talking now about the kind of congames and scams that have been an enduring part of the American scene. For example, there was a recent case in Utah in which the promoter was selling interests in a machine that supposedly processed shale to produce oil. The machine was designed with a hidden reservoir that was filled with commerical oil prior to demonstrations. Unsuspecting prospects were then shown a machine that apparently could grind up shale and process it to produce high-grade oil. Other scams have involved the sale of interests in non-existent mining property, Latin-American gold mining operations, master-record licensing agreements, and phony domestic and foreign banking operations. The ingenuity of these con-men is apparently endless, but the point is that these are not sophisticated fraudlent schemes of high finance. Instead it is more closely related to the patent medicine salesman of the last century. Such activities may be found in any city or town in the United States, not just in the financial centers of the country such as New York or Chicago.

As you can tell from the breadth of the five areas I have described to you, the Commission's enforcement activities are varied and numerous and reach far beyond the activities of professionals in the securities markets.

V. FINANCIAL SERVICES INDUSTRY TASK FORCE

As I mentioned earlier, there have been substantial

changes over the last few years in the structure of the financial services industry. Brokerage firms, for example, have expanded into quasi-banking and other non-traditional areas. There have been mergers with other financial institutions such as Bache with Prudential Insurance, Dean Witter with Sears, and Shearson with American Express. Some brokerage firms have introduced comprehensive money management programs, e.g., Merrill Lynch's cash management account. These accounts provide checking services similar to traditional bank checking accounts. Banks and savings and loans are introducing discount brokerage services and some have even acquired full-service brokerage subsidiaries. Bank of America, for example, has acquired Charles Schwab, Security Pacific National Bank has acquired several new brokerage subsidiaries, and over 400 of the nation's savings and loan institutions are expected to participate in a discount brokerage operation called Savings Association Investment Securities ("SAIS"). Interstate banking operations continue to spread and the nation's thrifts have acquired bank-like powers. The banks and thrifts have also recently introduced deposit accounts intended to compete directly with money market mutual funds. Finally, banks have been affiliating in various ways with investment companies in order to provide a means for sweeping excess account monies into money market funds.

These changes, and there are undoubtedly more to come, are radically restructuring the financial services industry and erasing the traditional separations between banking and commerce. In response to these changes, the Administration has established a Task Force led by Vice President Bush to re-examine the government's regulatory approach to the entire industry. Among other suggestions under consideration are proposals to merge some of the regulatory agencies and to reassign some of the existing regulatory responsibility.

I think all can agree on the idea of streamlining the regulatory process to assure uniform standards and to eliminate duplication. But the stakes, both from the standpoint of industry participants and regulators, are high and there are a number of issues that must be faced. Perhaps the best way for me to tie together some of my random thoughts about this effort would be to pose a few questions:

(1) Proponents of deregulation seem to be the strongest advocates of consolidating the federal regulatory agencies governing the financial services industry. But would consolidation into a single or a few agencies necessarily mean less regu-

lation? Or will a new regulator simply be a more powerful and intrusive presence than multiple, smaller agencies?

(2) Would the existence of a single, all powerful regulator have the potential for stifling innovation and creativity? For example, if all pooled investment vehicles have been subject to regulation by bank regulators, it is doubtful that money market funds would ever have been started.

(3) Would consolidation into a single agency mean fewer or less serious regulatory conflicts than those arising under the present system? For example, if securities and banking regulators were consolidated, and if a banking subsidiary of a publicly-held bank holding company became troubled, how would such an agency resolve the conflict inherent in protecting depositors on the one hand and protecting investors on the other? Depositors have been traditionally protected by dealing with the problem discretely so as to avoid a run on the bank. But protection of investors is generally premised upon full disclosure of all material facts. It seems to me that resolution of this conflict is often better solved by maintaining the separation of the regulatory agencies.

(4) Does the trend of permitting banks to engage in commerce carry with it the possibility that a situation may arise where the SEC will insist on access to bank records and scrutiny of bank transactions and business practices? And with what outcome to the enterprise, to investors, and to the relationship between the SEC and the banking regulators?

(5) Finally, if banks are permitted to manage mutual funds, does that carry with it the same potential for conflict and problems?

As you can see the Task Force faces a challenging set of issues. There is more at stake here than simply the restructuring of the federal regulatory scheme and the resultant impact on the territorial imperatives of the regulators.

VI. SOME FINAL THOUGHTS ABOUT THE COMMISSION

As you can see, the Commission has been involved in, and will continue to be involved in, a wide range of activities: processing filings, prosecuting fraud, overseeing the securities exchanges and securities markets, and dealing with the restructuring of the financial services industries.

How does the Commission do all this? What are its resources? You might find a few statistics and comparisons interesting. The Commission has a total budget of $85 million, a total staff of 1800, including 700 lawyers, of which 400 are in the enforcement division. That's nationwide. In the main office in Washington, there are 130 attorneys in enforcement. That may sound like a lot.

But consider:

1. The dollar volume of trading on the New York Stock Exchange on an average day is $6.3 billion. The Commission is supposed to oversee all of that activity. On a heavy trading day, e.g., 130 million shares, that becomes $11.7 billion. The Commission's entire annual budget is .7% of that daily amount. On an annual basis, the comparison is almost too small to be calculated.

2. The government securities market, which we do not oversee directly other than in the sense of policing fraud, is many times the size of exchange trading.

3. Over-the-counter trading

4. Any three good-sized New York, Chicago, Washington, or Los Angeles firms would have more attorneys than the entire Commission. And they generally represent the parties with whom the Commission litigates.

5. Last year, through various fees imposed on those who file documents with the Commission, the Commission collected and offset 94% of its expenses. The total cost, nationwide, to U.S. taxpayers was approximately $5,000,000.