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U.S. SECURITIES AND EXCHANGE COMMISSION**

**REMARKS BEFORE THE  
SECURITIES INDUSTRY ASSOCIATION 1993 ANNUAL CONVENTION**

**BOCA RATON, FLORIDA  
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- \* **The views expressed herein are those of Commissioner Beese and do not necessarily represent those of the Commission, other Commissioners, or the staff.**

*U.S. Securities and Exchange Commission  
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*On behalf of Chairman Levitt and my fellow Commissioners at the S.E.C., I thank you for inviting me here today.*

*Being able to address the leadership of the securities industry during these times when securities professionals -- including regulators -- can be patting themselves on the back for the prosperity that our markets are enjoying is no doubt an enviable position.*

*But instead of being another voice at this gathering trumpeting this year's market highs and record earnings, let me instead focus my remarks on a key issue that must be addressed in order to keep our markets prosperous in the years ahead. After all, I'm now from the SEC -- but having spend 14 years on Wall Street before coming here, I know that Washington has not yet found a way to repeal the law of market cycles.*

*But that doesn't mean Washington will stop trying. I'm reminded of the story about the old man who passed on to his grandson the three great lies in life. Of course, the first is "the check is in the mail." The second is "one size fits all." And the third is "If I'm elected, I won't raise your taxes." And after having spent the last two years in Washington, I think maybe there should be a fourth -- that is "I'm from Washington and I'm here to help."*

*In all seriousness, the SEC must at times play the adversarial role of regulating your actions, but I view the ultimate mission of the SEC as being partners with the industry in maintaining the integrity and the international competitiveness of our markets.*

*That's why I consider being here today so important. Your hard work and your dedication keep America strong. And you have every right to be proud of the work you do.*

*But along with that pride comes a profound obligation. An obligation to uphold the remarkable success of our capital markets. An obligation to work with the SEC, and with the people you serve, so that our markets maintain the highest standards of efficiency and effectiveness — not through the red tape of regulatory bureaucracy, but through the enlightened efforts of the securities industry itself.*

*Today, in 1993, our tremendous new potential for growth and progress makes this obligation even greater.*

*Today, our markets seem to be constantly flirting with new highs, and today, capital flows across our borders at the touch of a computer key. And*

*some predict that the information revolution of the 90's will increase our power to communicate and transact by one-hundred-fold over the next decade.*

*Along with this extraordinary capability comes new and increasingly sophisticated financial products that are making yesterday's simple terms of stocks and bonds seem a relic of the past. Indeed, today's complex financial instruments are better defined in terms of cash flow and volatility characteristics. In today's world of corporate finance, it is possible to take a plain vanilla, fixed-rate bond, and by financial engineering, change its payment structure, change its currency, change its maturity, change its rating, give it equity characteristics, and slice and dice it into tranches.*

*And today, we're witnessing an explosion of capitalism around the world, to the tune of 150 billion dollars of privatizations scheduled to come to market. This phenomenon -- coupled with market reforms from Shanghai to Budapest to Mexico City -- is intensifying the demand for capital all over the world. A demand that Wall Street will take the lead in fulfilling.*

*And, as we navigate the sometimes uncharted waters of today's new products and today's global markets, we must explore aggressive new ways to keep pace -- new approaches to regulation, and new ways for the securities industry to rise to these challenges without the strong arm of government*

*intervention. After all, when Adam Smith talked about the invisible hand, I don't think he envisioned that hand operating in the glove of excessive government.*

*Our ability to meet these changes -- to devise new approaches to protect our tradition of free and open markets -- will truly determine the strength of U.S. markets at the end of this decade.*

*I believe that our success rests on three critical areas -- high ethical standards; self-policing by the securities industry; and efficient government regulation.*

*Let's consider these three areas one at a time.*

*Number one, it is clear that no amount of regulation, no amount of legislation, no amount of moral persuasion can take the place of a strong code of ethics -- by individuals, by firms, and by our industry at large.*

*To me, ethics is about personal values. And in many ways our ethics defines us more than any other trait. Unlike physical characteristics, ethics is something that involves conscious choices by people about themselves.*

*And, not surprisingly, the choices people make do have consequences. Unlike other mistakes that routinely occur in life, mistakes of character are irretrievable.*

*In my own career as a banker, and now as a regulator, I have seen too many firms tarnished, too many careers ruined, too much public confidence shaken by the siren call of easy money.*

*We owe it to ourselves, and to the long-term strength of our markets, not merely to practice high standards, but to create an environment in which lapses are simply not tolerated.*

*This brings us to my second area of concern -- self-policing -- which is another way of saying "industry-wide ethics." As we all know, securities firms, unlike banks, do not work under the microscope of 22,000 federal regulators. Our industry operates on the high-wire of investor confidence -- without the benefit of a federal safety net.*

*Because the securities markets are by definition built on a foundation of public trust, the American people depend on the industry itself to maintain its integrity, and to be the stewards of its credibility.*

*That's why it is so significant that in the municipal market many of the largest securities firms have stopped the practice of "pay to play." The fact that this practice is no longer tolerated is testimony to the leadership of Arthur Levitt in partnership with the dedicated efforts of Frank Zarb.*

*This "gang of 17" firms is sending a message that the toughest laws and the strictest regulations could never send -- that we are here to serve the public, and that the public interest is not for sale.*

*There's more that can be done to build public confidence in the municipal markets -- in particular, to make these markets more "transparent," so that trade and quotation information is crystal clear for all to see. We have a long way to go before market participants -- both customers and dealers -- have enough on-going information to make educated choices. The industry should "hit the window" and take the lead in closing this information gap -- and doing so would only increase the viability and strength of our municipal markets.*

*Self-policing in the securities industry also plays a vital role when it comes to sales practices, suitability rules, and supervisory standards. As many of you know, and have encouraged, the S.E.C. is now completing a study on the hiring, retention and supervisory practices of large firms with regard to brokers.*

*In particular, the problem we are exploring is how many so-called "bites of the apple" a broker can take before being barred from the industry.*

*The report, known as the "Large Firm Project," involved an exhaustive examination of large NYSE member firms. While the report is not yet complete, the staff's examinations have confirmed the need to comprehensively address the area of sales practice abuses. Specifically, the exams raised concerns regarding excessive trading, unsuitable recommendations, unauthorized trading, and mutual fund switching. Of course, such potential abuse also raises concerns about whether firms have implemented adequate supervisory procedures.*

*Together, we must take effective action to address these concerns. At the very least, firms should be encouraged to provide their Compliance and Legal departments with the ability to affect employment decisions. And the Commission, along with the SRO's, must seek increased sanctions against brokers who commit abuses -- and the people responsible for their supervision.*

*And the problem of rogue brokers has aroused the interest of Capitol Hill. There is talk of a legislative proposal to adopt a "three strikes and you're out" policy for repeat offenders. While none of us can quarrel with the intent of such legislation, the industry must either take action on its own or face the prospect of federal sentencing guidelines for sales practice abuses.*



*Just like we have a "know thy customer" rule -- it's high time firms adopt a "know thy brokers" rule. People in the industry know who operates at the margin -- and abuses are often too tolerated from big producers.*

*I am here to tell you, this Commission will not tolerate the presence of rogue brokers in our markets. If you don't eliminate them -- we will -- and those with supervisory responsibility will be held accountable.*

*Compensation practices for brokers are right at the center of this issue. The pay for performance revolution that is sweeping across corporate America long has been the hallmark of the senior ranks on Wall Street. The CEO's in this room are no strangers to being compensated for achieving long-term "bottom line" results.*

*I must say, however, that the more I became immersed in the executive compensation debates at the SEC these past two years, the more ironic I found it that Wall Street -- except for the most senior ranks -- is too often short-term and "top line" oriented. Brokers, branch managers and some division heads are compensated on monthly and quarterly production -- often without regard to the long "tail of risk" that some of those revenues contain.*

*If anyone needs reminders about how large -- and how personal those tails of risk can become -- I would refer you to the over one billion dollars of settlements the SEC has received from major firms alone over the past five years.*

*And as these cases have shown, the Commission is fully prepared to pursue failure to supervise sanctions right up the chain of command. Senior management should now realize that geographic distances do not insulate them from rogue brokers and gunslinging branch offices.*

*Compensation policies that encourage quantity over quality create an ethical cancer in a firm. Yes, a fast spreading cancer -- and one that is cured not by chemotherapy, but instead by litigation and ruined careers.*

*By now I hope it is clear from my remarks that the clock is ticking in Washington. Senior management, and their boards of directors, can -- and must -- take action on this issue before new laws are imposed to protect the public from perceived abuses.*

*The way an industry ends up with mandatory sentencing guidelines is quite clear. Public disapproval mounts over the way discretionary penalties are*

*imposed -- Congress takes an interest -- and Congress decides to take the discretion out of the process.*

*Following the '87 crash, the securities industry collectively decided that it was time to "get their house in order" with regard to risk management of capital structures and complex financial instruments. Today, the results are noticeable and commendable. The same needs to happen now with regard to rogue brokers, sales practices and supervision.*

*It is not unrelated that the securities industry has become fertile ground for the litigation frenzy sweeping America. Or maybe I should call it the plaintiff's lawyer's dream lottery -- you always have a chance to win big, and even those with losing tickets can usually settle for a prize. I am personally preoccupied with the competitive drag that frivolous litigation imposes on our society -- and I believe the SEC, Congress, state legislatures, and each of you must take up arms against the legal extortion that is increasingly driving our business offshore.*

*But make no mistake about it, the securities industry will receive no public sympathy, and no public support, until it gets tough on sales practice abuses.*

*One final, related issue is investor education. While many of us are rightfully encouraged by the return of small investors to public markets, there is a troubling gap between participation in the markets, and education about the risks involved. In a recent S.E.C. survey, 36 percent of the respondents believed that mutual funds purchased through a stockbroker are federally-insured.*

*This kind of misunderstanding is highly damaging, because the uninformed investor will often flee Wall Street at the first sign of turbulent markets. The stability of the markets demands that the industry educate even the smallest investors about the short-term risks and long-term rewards of informed investment.*

*High ethical standards and vigorous self-policing are crucial to the strength and success of our capital markets. But in an imperfect world, they are not enough. And while regulation should never be a first resort, there is a lot that can be achieved through regulation to protect investors and promote public confidence.*

*Right now the S.E.C. is working very hard to ensure that our regulations keep pace with the fast and furious changes in capital markets.*

*As many of you are aware, the S.E.C. will soon release a report entitled "Market 2000" -- an effort started under Chairman Breeden to examine equity market developments and address impediments to fair and competitive markets. While there has been a great deal of speculation about the report and the changes it might bring, it is safe to say that its release will be the beginning of the process, not the end.*

*And while there is a possibility that it will be released in the next few weeks, we will not compromise quality in a rush to get the report out the door.*

### *Conclusion*

*Some of the veterans in the room certainly remember the SEC's so-called Institutional Investor study in the mid-70's. Back then, Wall Street was perceived as a club -- and the results of this study helped open the markets to everyone.*

*But not everything has changed for the better. Back then, firms were partnerships and peoples careers were tied to the long-term success of their firms. During the last decade, Wall Street's partnerships have become public companies -- and people have become fungible commodities moving from one firm to the next. Compensation has become more transaction based and the sense of a "common bond" within firms has certainly eroded.*

*I don't want to wax nostalgic about the days gone by -- but we do need to focus on the entire "culture" of Wall Street today. Loyalty to one's firm and loyalty to one's industry must again become paramount to loyalty to one's self - - no matter what your rank and position in today's Wall Street.*

*Our markets are built upon a foundation of trust -- both with investors and with other market professionals. When the founders of Wall Street met under the buttonwood tree 200 years ago they didn't have an army of lawyers and regulators to dictate business practices -- they relied on enlightened self interest, a common code of conduct, and a handshake. Something that was still evident in the early part of the careers of many of the people in this room.*

*Together, we need to bring the "culture" of Wall Street back to this standard -- and the way to start is by removing roving rogue brokers -- and today's compensation structures that allow them to flourish.*

*Thank you.*