NEWS

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"THE SEC AS A DEVELOPMENTAL AGENCY"

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IN THE INTEREST OF FULL DISCLOSURE, I FEEL I SHOULD BEGIN THIS SPEECH WITH A DISCLAIMER. I AM NOT A VERY GOOD AFTER DINNER SPEAKER. MY SPEECHES TEND TO BE SERIOUS AND HEAVY. THEY ARE EASIER TO DIGEST AFTER BREAKFAST THAN AFTER DINNER. FURTHERMORE, I MADE THIS SAME DISCLAIMER TO MORTY WEISS BEFORE I AGREED TO THIS SPEAKING ENGAGEMENT.

MORTY ASSURED ME THAT YOU WOULD BE A VERY SOPHISTICATED AND INTERESTED AUDIENCE AND THAT I COULD SPEAK TO YOU ON ANY SUBJECT. NEVERTHELESS, IF YOU FIND AN AFTER DINNER SPEECH TOO BORING TO FOLLOW, BUT YOU WANT SOMETHING OF BUSINESS INTEREST, TO SHOW TO YOUR PARTNERS WHEN YOU RETURN TO THE OFFICE, I WILL BE HAPPY TO SEND A COPY OF THESE REMARKS TO ANYONE WHO WILL LEAVE ME A BUSINESS CARD.

THE REASON I AM SO SKEPTICAL ABOUT YOUR APPRECIATION FOR MY SPEECH IS THAT I KNOW MORE ABOUT TRADERS THAN YOU MIGHT ASSUME. MY FIRST CONTACT WITH THE SECURITIES INDUSTRY WAS A JOB IN THE TRADING ROOM OF AN OVER-THE-COUNTER MARKET MAKER. I WAS A BOOKISH SORT AND WHEN THERE WAS A SLOW DAY IN THE OFFICE I USED TO TRY AND READ ABOUT THE STOCK MARKET. ONE AFTERNOON THE HEAD TRADER CAUGHT ME READING A TEXTBOOK ON ECONOMICS.

"WHAT ARE YOU READING THAT FOR?" HE ASKED. "WELL SIR," I REPLIED, "I WOULD LIKE TO LEARN SOMETHING ABOUT THIS BUSINESS."

"WHAT A WASTE OF TIME," HE REACTED. "YOU WON'T LEARN ABOUT THIS BUSINESS IN A BOOK. IT'S ALL JUST SUPPLY AND DEMAND."

THIS CONVERSATION MUST HAVE SEEMED MEANINGFUL TO ME BECAUSE IT STUCK IN MY MEMORY FOR TWENTY YEARS. AND ALTHOUGH I HAVE CONTINUED TO APPROACH THE SECURITIES INDUSTRY FROM A SOMEWHAT INTELLECTUAL VANTAGE POINT, I AM NOT PERSUADED THAT THE HEAD TRADER WAS WRONG.

NEVERTHELESS, I SPEAK TO YOU TONIGHT ABOUT THE ECONOMICS OF THE TRADING MARKETS AS A REGULATOR, AND REGULATION TODAY IS A FORMAL AND SERIOUS BUSINESS. THE SECURITIES INDUSTRY AND THE SECURITIES AND EXCHANGE COMMISSION ("SEC") ARE BEING CALLED UPON TO SOLVE DIFFICULT PROBLEMS IN A MANNER WHICH WILL SATISFY A DISSATISFIED AND DISTRUSTFUL PUBLIC. AT A TIME WHEN THE SEC HAS MANY NEW RESPONSIBILITIES WITH RESPECT TO THE SECURITIES MARKETS, OUR DECISION MAKING PROCESSES HAVE BECOME SUBJECT TO INCREASINGLY CRITICAL PUBLIC INTEREST AND SCRUTINY.

IN 1975 THE CONGRESS DETERMINED THAT OUR "SECURITIES MARKETS ARE AN IMPORTANT NATIONAL ASSET WHICH MUST BE PRESERVED AND STRENGTHENED." CONGRESS THEN DIRECTED THE COMMISSION TO USE ITS AUTHORITY TO FACILITATE THE ESTABLISHMENT OF A NATIONAL MARKET SYSTEM FOR SECURITIES. SIMILARLY, CONGRESS DIRECTED US TO FACILITATE THE ESTABLISHMENT OF A NATIONAL SYSTEM FOR THE PROMPT AND ACCURATE CLEARANCE AND SETTLEMENT OF TRANSACTIONS IN SECURITIES. IN SO DOING, CONGRESS GAVE OUR AGENCY A DEVELOPMENTAL ROLE WITH REGARD TO THE SECURITIES MARKETS WHICH WAS IN SOME WAYS NEW.

FURTHERMORE, THE COMMISSION WAS GIVEN THESE NEW RESPONSIBILITIES AT A TIME OF GROWING PUBLIC DISTRUST OF REGULATION AND REGULATORS, WHICH HAS LED TO THE IMPOSITION OF VARIOUS CONTROLS, SUCH AS THE GOVERNMENT IN THE SUNSHINE ACT, ON THE DECISION MAKING PROCESSES OF GOVERNMENT. I SEE DANGERS, AS WELL AS OPPORTUNITIES, IN THESE DEVELOPMENTS, FOR BOTH THE SEC AND THE INDUSTRY. IF YOU WILL INDULGE ONE OF YOUR REGULATORS, WHO IS WONT TO DEAL WITH THE CHALLENGES OF THE SECURITIES MARKETS THROUGH WORDS AND IDEAS INSTEAD OF THROUGH THE POSSIBLY MORE COMPREHENSIBLE MEANS OF SUPPLY AND DEMAND, I WOULD LIKE TO SHARE WITH YOU MY CONCERNS AND SUGGESTIONS REGARDING BETTER REGULATION BY A MATURE AGENCY WITH NEW WORK TO DO.

SEVERAL MONTHS AGO I SPOKE TO ANOTHER INDUSTRY GROUP ABOUT THE GROWING PAINS THE COMMISSION WAS HAVING IN CHANGING FROM A PRIMARILY LAW ENFORCEMENT TO A PARTLY PROMOTIONAL AGENCY. OF ALL THE SPEECHES I HAVE GIVEN AS A COMMISSIONER, THAT SPEECH SPARKED THE MOST INTEREST AND CONTROVERSY AND WAS THE MOST MISUNDERSTOOD. SO IN TRYING TO SPEAK ON THIS GENERAL SUBJECT AGAIN, I DECIDED TO START BY DEFINING WHAT I MEAN BY "PROMOTIONAL," "REGULATORY" AND "PROSECUTORIAL" GOVERNMENT ACTIVITIES.

I DEFINE A PROMOTIONAL FUNCTION AS A GOVERNMENT ACTIVITY DESIGNED TO BENEFIT OR FOSTER PRIVATE BUSINESS GROWTH OR DEVELOPMENT WHICH CONGRESS HAS DETERMINED IS IN THE PUBLIC WELFARE. THIS FUNCTION COULD ALSO BE LABELED A DEVELOPMENTAL FUNCTION, AND I WILL SOMETIMES USE THAT TERM TONIGHT.

A PROSECUTORIAL FUNCTION IS LAW ENFORCEMENT; GOVERNMENT ACTION WHICH VINDICATES A STATUTORY NORM. REGULATORY FUNCTIONS ARE OF MANY TYPES, BUT THEY ARE BASICALLY STANDARD SETTING ACTIVITIES.

THESE ACTIVITIES CAN BEST BE VIEWED ON A CONTINUUM FROM PURE PROMOTIONAL OR BENEFIT GRANTING ON THE ONE END, TO PURE LAW ENFORCEMENT ON THE OTHER END, WITH VARIOUS TYPES OF REGULATORY ACTIVITIES IN THE MIDDLE. PURE PROMOTIONAL ACTIVITIES WOULD INCLUDE DIRECT CASH GRANTS, LOANS AT INTEREST RATES BELOW MARKET OR GUARANTEES OF INDEBTEDNESS. THE SEC NEVER HAS HAD AND DOES NOT NOW HAVE ANY PURE PROMOTIONAL FUNCTIONS. THE SEC IS NOT A PROMOTER AND I DO NOT BELIEVE IT WOULD BE IN THE BEST INTERESTS OF EITHER THE INDUSTRY OR THE AGENCY FOR THE SEC TO BECOME A PROMOTER, PARTICULARLY IF PROMOTION IS EQUATED WITH PROTECTION OF THE SECURITIES INDUSTRY.

PURE LAW ENFORCEMENT IS THE PROSECUTION OF VIOLATIONS OF THE LAW. WHEN THE SEC GOES TO COURT TO ENJOIN A MARKET MANIPULATOR, IT IS ENGAGED IN PURE LAW ENFORCEMENT.

IN BETWEEN THESE EXTREMES ON THE CONTINUUM OF GOVERNMENT ACTIVITY IS REGULATION, WHICH MAY HAVE MULTIPLE OBJECTIVES AND MAY TAKE MULTIPLE FORMS. LICENSING, IS A COMMON REGULATORY ACTIVITY, IN WHICH STANDARDS ARE ESTABLISHED BY IMPOSING REQUIREMENTS UPON PERSONS DESIRING TO OBTAIN A LICENSE. NEVERTHELESS LICENSING MAY BE PURSUED IN A PROSECUTORIAL MANNER, IF IT IS PURSUED PRIMARILY FOR THE PURPOSE OF ENFORCING EXISTING STANDARDS.

THIS HAS BEEN THE CASE AT THE SEC IN THE AREA OF BROKER-DEALER DISCIPLINARY PROCEEDINGS, WHICH FOR THE MOST PART INVOLVE LICENSE SUSPENSIONS OR REVOCATIONS. ALTERNATIVELY, WHERE LICENSING GRANTS A BUSINESS ENTITY AN EXCLUSIVE FRANCHISE, FOR EXAMPLE, THE REGISTRATION OF A SINGLE DESIGNEE TO RECEIVE AND PROCESS LOST AND STOLEN SECURITIES REPORTS, IT CAN BE A PROMOTIONAL AS WELL AS A REGULATORY ACTIVITY.

SIMILARLY, RATE MAKING IS A COMMON REGULATORY ACTIVITY UTILIZED TO PROTECT CONSUMERS. BUT RATE MAKING CAN BE CONDUCTED AS A PROSECUTIONAL FUNCTION TO IMPOSE PENALTIES ON UNDESIRABLE BUSINESS ACTIVITY OR IN A PROMOTIONAL WAY TO ASSIST IN THE DEVELOPMENT OF BUSINESS ENTERPRISE.

NOW THE SEC HAS ALWAYS HAD A GENERAL MANDATE TO PROMOTE FAIR AND HONEST MARKETS IN SECURITIES. BUT CONGRESS DID NOT PREVIOUSLY GIVE OUR AGENCY THE MORE SPECIFIC POLICY DIRECTIVES OR LEGAL AUTHORITY AND MECHANISMS TO COMPEL THE INDUSTRY TO ADOPT PARTICULAR TECHNOLOGICAL DEVELOPMENTS OR TO INTERFERE WITH ECONOMIC FORCES CHANGING THE INDUSTRY. SINCE 1934 THE COMMISSION HAS BEEN PROMULGATING REGULATIONS WHICH ARTICUATE BEHAVIORAL STANDARDS FOR THE INDUSTRY. HOWEVER, THE COMMISSION ENDEAVORED TO KEEP THE SECURITIES MARKETS FAIR AND HONEST PRIMARILY BY LAW ENFORCEMENT TECHNIQUES. IF A MARKET PARTICIPANT DID NOT MEASURE UP TO EXPECTED STANDARDS OF CONDUCT, HE WAS ENJOINED, BARRED FROM THE BUSINESS OR CRIMINALLY PROSECUTED.

THE 1975 AMENDMENTS TO THE FEDERAL SECURITIES LAWS GAVE THE SEC SOME RESPONSIBILITIES WHICH I BELIEVE HAVE A MIXED REGULATORY AND PROMOTIONAL QUALITY BECAUSE THEY GIVE THE COMMISSION THE ABILITY TO IMPACT THE ECONOMICS OF THE TRADING MARKETS FOR THE PURPOSE OF FACILITATING THEIR DEVELOPMENT. THESE RESPONSIBILITIES INCLUDE THE LINKING OF MARKETS THROUGH COMMUNICATION AND DATA PROCESSING FACILITIES; THE CONSOLIDATION OF MARKETS IN SECURITIES SUITABLE FOR AUCTION TRADING; THE CREATION OF A PROGRAM FOR LOST AND STOLEN SECURITIES; AND THE ESTABLISHMENT OF A NATIONAL SYSTEM FOR CLEARANCE AND SETTLEMENT OF SECURITIES TRANSACTIONS.

THE COMMISSION ALSO WAS GIVEN A VARIETY OF NEW REGULATORY TOOLS. THE COMMISSION NOW LICENSES AND APPROVES THE REGISTRATION OF MARKET PARTICIPANTS OVER WHICH WE DID NOT PREVIOUSLY HAVE JURISDICTION -- DEPOSITORIES, CLEARING AGENCIES, TRANSFER AGENTS AND INFORMATION PROCESSORS. FURTHER, THE COMMISSION MUST AFFIRMATIVELY ACT TO APPROVE ALL RULE CHANGES OF THE EXCHANGES, NASD AND OTHER SELF-REGULATORY ORGANIZATIONS. BROKERAGE COMMISSION RATES WERE UNFIXED IN 1975 SO THAT THE SEC WOULD NOT BE TRANSFORMED INTO A PUBLIC UTILITY RATE MAKING COMMISSION. NEVERTHELESS, THE SEC WAS GIVEN SOME RATE MAKING AUTHORITY.

DECISION MAKING IN THESE AREAS IMPACTS PRIVATE ECONOMIC INTERESTS IN WAYS WHICH LAW ENFORCEMENT OR PURE REGULATION DO NOT, AND CAN LEAD TO A CONFUSION ABOUT THE PURPOSE OF REGULATION.

A RECENT STUDY ON FEDERAL REGULATION BY THE SENATE COMMITTEE ON GOVERNMENTAL AFFAIRS CONCLUDED THAT PROMOTIONAL AND REGULATORY PROGRAMS CANNOT COMFORTABLY CO-EXIST IN A SINGLE AGENCY. THE STUDY FOUND THAT WHEN BOTH FUNCTIONS ARE ASSIGNED TO A SINGLE AGENCY, THERE IS A GENERAL TENDENCY FOR THE AGENCY'S PROMOTIONAL MISSION TO PREDOMINATE. THE SEC'S PROSECUTORIAL FUNCTION IS WELL KNOWN AND WELL DEVELOPED. BECAUSE THE COMMISSION IS DIRECTLY RESPONSIBLE FOR ENFORCEMENT OF THE FEDERAL SECURITIES LAWS, IT IS IMPORTANT THAT OUR PROSECUTORIAL CAPABILITY IN NO WAY BE COMPROMISED BY OUR NEW DEVELOPMENTAL FUNCTIONS. IT IS EQUALLY IMPORTANT THAT OUR DEVELOPMENTAL ROLE BE CARRIED OUT WITH A CONCERN FOR THE GENERAL ECONOMIC HEALTH OF THE INDUSTRY, LEST WE HARM THE MARKETS WE ARE DIRECTED TO HELP.

THE EXISTENCE OF PROSECUTORIAL, REGULATORY AND PROMOTIONAL FUNCTIONS WITHIN A SINGLE AGENCY NECESSARILY GIVES RISE TO CERTAIN TENSIONS AND PROBLEMS.

GOVERNMENT REGULATION OF BUSINESS IN THIS COUNTRY HAS LONG INVOLVED AN EFFORT TO BALANCE THE NEED FOR FOSTERING THE NATIONAL ECONOMY BY AIDING BUSINESS DEVELOPMENT AGAINST THE OBJECTIVE OF GUARDING AGAINST INIMICAL OR UNFAIR BUSINESS PRACTICES. HOWEVER, INDEPENDENT REGULATORY AGENCIES DO NOT ALL HAVE PROSECUTORIAL, REGULATORY AND PROMOTIONAL FUNCTIONS.

ONE REASON THE SEC HAS BEEN ABLE HISTORICALLY TO AVOID SUCCUMBING TO THESE CONFLICTS BETWEEN PROMOTIONAL, REGULATORY AND PROSECUTORIAL PROGRAMS IS THAT THE SCHEME OF FEDERAL SECURITIES REGULATION INCLUDES SELF-REGULATION. THE SECURITIES EXCHANGE ACT OF 1934 RECOGNIZED THE REGULATORY ROLE OF THE STOCK EXCHANGES, AND IN 1938 CONGRESS EXTENDED THE CONCEPT OF SELF-REGULATION TO OVER-THE-COUNTER BROKERS AND DEALERS, BY ENACTING THE MALONEY ACT WHICH LED TO THE FORMATION OF THE NATIONAL ASSOCIATION OF SECURITIES DEALERS ("NASD").

THE SELF-REGULATORY ORGANIZATIONS OPERATE IN THE PUBLIC INTEREST TO KEEP OUR MARKETS FAIR AND HONEST BY SETTING STANDARDS REGARDING JUST AND EQUITABLE PRINCIPLES OF TRADE AND BY POLICING UNETHICAL AND ILLEGAL PRACTICES. AND THE SELF-REGULATORS ARE ALSO BUSINESS ENTITIES WHICH PROMOTE THEIR ECONOMIC SELF-INTEREST AND THE BUSINESS INTERESTS OF THEIR MEMBERS. IN BOTH RESPECTS THEY COMPLEMENT AND SUPPLEMENT THE COMMISSION'S PROGRAMS, ENABLING THE SEC TO DEAL WITH THE MORE SENSITIVE AND LESS DETAILED ISSUES.

BUT, THE SELF-REGULATORY ORGANIZATIONS HAVE BEEN CRITICIZED, FROM TIME TO TIME, BOTH BY CONGRESS AND THE SEC, FOR THEIR EXCLUSIONARY AND ANTI-COMPETITIVE BEHAVIOR. IN OTHER WORDS, THEY HAVE PROSECUTORIAL, REGULATORY AND PROMOTIONAL RESPONSIBILITIES, AND THEY HAVE AT TIMES LET THEIR PROMOTIONAL FUNCTIONS PREDOMINATE OVER THEIR REGULATORY AND PROSECUTORIAL FUNCTIONS.

In the late 1960s the self regulatory organizations failed adequately to respond to the long term promotional needs of the industry or to take the requisite prosecutorial or regulatory initiatives to solve the unsafe and unsound conditions in the securities markets. The SEC's oversight of the self-regulators also proved insufficient. The unfortunate result was an erosion of public confidence in the securities markets memoralized in some very critical congressional reports. Ultimately, the Congress passed the Securities Acts Amendments of 1975.

These amendments gave the SEC a much greater role as overseer of the self-regulatory organizations. We must now act to affirmatively approve new rules or amendments to existing rules of the self-regulatory organizations. In so doing, our agency must find that such rule changes are consistent with the requirements of the Securities Exchange Act of 1934. Since it would usually be impossible or at least impractical for a self-regulatory organization to embark upon a new venture, or deliver a new type of system or service to its members without a rule change, this statutory amendment directly involves the SEC in the promotional activities of the stock exchanges and the NASD.

In addition, the 1975 Amendments gave the SEC the authority to abrogate or change rules of most of the self-regulatory organizations in furtherance of the purposes of the Exchange Act. The SEC also now has the power to

AUTHORIZE OR REQUIRE THE SELF-REGULATORY ORGANIZATIONS TO ACT JOINTLY WITH RESPECT TO MATTERS AS TO WHICH THEY SHARE AUTHORITY IN PLANNING, DEVELOPING, OPERATING OR REGULATING A NATIONAL MARKET SYSTEM OR FACILITIES THEREOF. THE 1975 AMENDMENTS ALSO INVOLVED THE SEC MORE DIRECTLY AND MORE ACTIVELY IN OVERSIGHT OF THE SURVEILLANCE AND DISCIPLINARY ACTIVITIES OF THE SELF-REGULATORY ORGANIZATIONS.

THESE NEW POWERS, COUPLED WITH THE GENERAL CONGRESSIONAL MANDATE TO FACILITATE THE ESTABLISHMENT OF NATIONAL MARKET AND CLEARANCE SYSTEMS HAVE GIVEN THE COMMISSION RESPONSIBILITIES FOR DIRECT AS WELL AS INDIRECT DEVELOPMENTAL, REGULATORY AND LAW ENFORCEMENT ACTIVITIES.

THUS, ALTHOUGH THE SELF-REGULATORY ORGANIZATIONS ARE NOW ASSISTED IN RESOLVING THE CONFLICTS WHICH THEY HAVE BETWEEN THEIR PROMOTIONAL, REGULATORY AND PROSECUTORIAL ROLES BY ACTIVE SEC OVERSIGHT, THE SEC MUST NOW DEAL WITH THESE CONFLICTS INTERNALLY.

AS A COMMISSIONER OF THE SEC I AM DEEPLY CONCERNED ABOUT HOW THE SEC WILL RESPOND TO ITS NEW DEVELOPMENTAL ROLE AND HOW PROMOTIONAL RESPONSIBILITIES MAY CHANGE OUR AGENCY. THE SEC HAS ALWAYS ENJOYED AN EXCELLENT REPUTATION. I HOPE AND EXPECT THAT WE WILL CONTINUE TO DO SO. BUT GOVERNMENT AGENCIES WITH A PRIMARILY PROSECUTORIAL FUNCTION SEEM BETTER ABLE TO MAINTAIN THE PUBLIC'S CONFIDENCE THAN AGENCIES WHICH ARE PROMOTIONAL. PROMOTIONAL ACTIVITIES ARE PERHAPS MORE SUSCEPTIBLE TO CORRUPTION AND THE APPEARANCE OF IMPROPER RELATIONSHIPS WITH A REGULATED INDUSTRY.

TONIGHT I HAVE CALLED YOUR ATTENTION TO THE PROBLEMS I PERCEIVE IN THE COMBINATION OF DEVELOPMENTAL, REGULATORY AND PROSECUTORIAL ROLES IN A SINGLE AGENCY. I WOULD ALSO LIKE TO DISCUSS SOME POSSIBLE SOLUTIONS TO THESE PROBLEMS.

FIRST, THE SELF-REGULATORY ORGANIZATIONS MUST REMAIN VIABLE AND MUST CONTINUE TO EXERCISE BOTH PROMOTIONAL AND REGULATORY RESPONSIBILITIES. IN MANY AREAS THE MARKETPLACE CAN PROVE BOTH A BETTER PROMOTER AND A BETTER REGULATOR THAN THE GOVERNMENT. PERSONALLY, I HAVE ALWAYS FOUND THE KINETIC ENERGY OF THE TRADING MARKETS INTELLECTUALLY STIMULATING. I AM CONFIDENT THAT THE MENTAL ACUITY WHICH IS REQUIRED TO COMPETE IN THOSE MARKETS CAN BE HARNESSED FOR THE PUBLIC GOOD AS WELL AS PRIVATE GAIN.

SECOND, NEITHER THE COMMISSION NOR THE INDUSTRY SHOULD BECOME OVERLY ENTHUSIASTIC ABOUT THE SUGGESTION THAT THE SEC NOW HAS CERTAIN PROMOTIONAL FUNCTIONS. IN MY OPINION, THE SEC SHOULD NOT INTERPRET ITS MANDATE UNDER THE 1975 AMENDMENTS TO AUTHORIZE THE SUBSTITUTION OF ITS JUDGMENT FOR THE BUSINESS JUDGMENT OF THE INDUSTRY CONCERNING NEW PRODUCTS, SERVICES OR SYSTEMS. FURTHER, TO THE EXTENT THAT THE PRIVATE SECTOR CAN INITIATE AND PROMOTE EXPERIMENTS IN THE DEVELOPMENT OF NATIONAL MARKET AND CLEARANCE SYSTEMS, THE SEC SHOULD REFRAIN FROM COMPELLING THE INDUSTRY TO USE NEW AND POSSIBLY UNPALATABLE OR UNWORKABLE SYSTEMS.

THIRD, THE SEC CAN RESOLVE CERTAIN CONFLICTS BETWEEN OUR PROMOTIONAL AND REGULATORY FUNCTIONS BY A FUNCTIONAL DIVISION OF PERSONNEL. AS YOU KNOW, OUR DIVISION OF ENFORCEMENT IS SEPARATE FROM OUR OPERATING DIVISIONS INCLUDING THE DIVISION OF MARKET REGULATION. ALTHOUGH A STRICT SEPARATION OF FUNCTIONS IS NOT ALWAYS CONSISTENT WITH THE MOST EFFICIENT USE OF STAFF RESOURCES, AS A GENERAL PRINCIPAL THERE IS VALUE IN INSULATING THE PROSECUTORIAL FUNCTION.

BUT LAST AND OF GREATEST IMPORTANCE, IN WHAT MUST BE OUR MUTUAL EFFORTS TO MAINTAIN THE PUBLIC'S CONFIDENCE, IS THE CONDUCT OF OUR AFFAIRS HONESTLY AND IN PUBLIC. LAST YEAR THE GOVERNMENT IN THE SUNSHINE ACT BECAME LAW. IT REQUIRES MOST OF THE FEDERAL REGULATORY AGENCIES TO OPEN THEIR RULEMAKING AND MOST OTHER MEETINGS TO THE PUBLIC. THE STATUTE ALSO PROHIBITS EX PARTE COMMUNICATIONS BETWEEN AGENCY DECISION MAKERS AND INTERESTED OUTSIDE PERSONS WITH RESPECT TO THE MERITS OF PENDING FORMAL PROCEEDINGS. THE BASIC PREMISE OF THE SUNSHINE ACT IS THAT GOVERNMENT IS AND SHOULD BE THE SERVANT OF THE PEOPLE, AND THEREFORE IS AND SHOULD BE FULLY ACCOUNTABLE TO THEM.

BEFORE THE SEC CAN ADOPT ANY RULE OR ISSUE ANY ORDER, THE AGENCY MUST FOLLOW CERTAIN PROCEDURES REQUIRED BY THE FEDERAL ADMINISTRATIVE PROCEDURE ACT AND THE SECURITIES STATUTES. IN GENERAL, IN MAKING THE KIND OF DECISIONS NECESSARY TO IMPLEMENT THE 1975 AMENDMENTS RESPECTING THE NATIONAL MARKET AND CLEARANCE SYSTEMS,

THE SEC ENGAGES IN WHAT IS CATEGORIZED AS INFORMAL RULEMAKING OR SO-CALLED INFORMAL ADJUDICATION. THIS USUALLY MEANS THAT (1) NOTICE IS PUBLICLY GIVEN OF A PARTICULAR PROPOSED ACTION, (2) WRITTEN (OR SOMETIMES ORAL) COMMENTS ARE SOLICITED, (3) A PUBLIC FILE IS MAINTAINED OF THOSE COMMENTS, AND FINALLY (4) ACTION IS TAKEN BASED ON THE COMMENTS AND INFORMATION COMPILED WITH A PUBLISHED STATEMENT OF THE BASIS AND PURPOSE FOR THE DECIDED-UPON ACTION.

THE COMMISSION HAS A GOOD DEAL OF LATITUDE IN CHOOSING THE MANNER IN WHICH THESE INFORMAL PROCEDURES ARE FOLLOWED AND DISCRETION AS TO WHAT OTHER MORE FORMAL PROCEDURES SHOULD BE UTILIZED. IN A RECENT CASE 1/ THE UNITED STATES SUPREME COURT STRESSED THAT FORMULATION OF THE PROCEDURES AN AGENCY UTILIZED IN INFORMAL RULEMAKING IS BASICALLY A MATTER OF AGENCY DISCRETION. INFORMAL RULEMAKING NEED NOT BE BASED SOLELY ON THE TRANSCRIPT OF ANY HEARING HELD BEFORE THE AGENCY. INDEED A FORMAL HEARING NEED NOT EVEN BE HELD.

THE LATITUDE WHICH A REGULATORY AGENCY HAS IN THE INFORMAL RULEMAKING PROCESS HAS CERTAIN PITFALLS, HOWEVER, PARTICULARLY IN SITUATIONS WHERE A PROPOSED AGENCY RULE HAS ECONOMIC CONSEQUENCES WHICH FAVOR SOME BUSINESS ENTITIES OVER OTHERS. IN SUCH A SITUATION EX PARTE CONTACTS CAN PROVE TROUBLESOME. DURING THE PAST YEAR THE D. C. CIRCUIT COURT OF APPEALS HANDED DOWN TWO OPINIONS DEALING WITH THE PROPER SCOPE OF EX PARTE CONTACTS DURING THE COURSE OF INFORMAL RULEMAKING PROCEEDINGS.

1/ VERMONT YANKEE NUCLEAR POWER CORP. v. NRDC, 435 U.S.___ (1978).

THESE DECISIONS ARE IMPORTANT NOT ONLY BECAUSE EX PARTE CONTACTS ARE HARD TO COMPLETELY AVOID AS A PRACTICAL MATTER, BUT ALSO BECAUSE AGENCY PERSONNEL AND COMMISSIONERS MUST HAVE CONTINUING CONVERSATIONS WITH INDUSTRY REPRESENTATIVES IN ORDER TO INCREASE AND MAINTAIN AGENCY EXPERTISE.

IN THE FIRST CASE, HOME BOX OFFICE V. FCC, 2/ THE COURT OVERTURNED CERTAIN CABLE TV PROGRAMMING RULES ADOPTED BY THE FEDERAL COMMUNICATIONS COMMISSION IN PART BECAUSE OF EX PARTE CONTACTS BY INTERESTED PERSONS WITH FCC COMMISSIONERS AND EMPLOYEES BETWEEN THE TIME THE COMMENT PERIOD CLOSED AND THE TIME WHEN THE RULES WERE ADOPTED. THE COURT HELD THESE CONTACTS WERE IMPROPER BECAUSE SUCH CONDUCT PREVENTED PUBLIC SCRUTINY OF THE EX PARTE COMMENTS AND PRECLUDED AN ADEQUATE RECORD FOR COURT REVIEW.

SUBSEQUENTLY, HOWEVER, IN THE SECOND CASE, ACTION FOR CHILDRENS TELEVISION V. FCC 3/ THE SAME COURT NARROWED ITS HOLDING IN HOME BOX OFFICE. IN CHILDREN'S TELEVISION, THE COURT SAID THAT SUCH EX PARTE COMMUNICATIONS NEED ONLY BE EXPLICITLY DISCLOSED AND MADE PART OF THE RECORD "WHEN THERE ARE COMPETING PRIVATE CLAIMS TO A VALUABLE PRIVILEGE OR THERE IS SELECTIVE TREATMENT OF COMPETITIVE BUSINESS INTERESTS OF SIGNIFICANT MONETARY VALUE." THE COURT RECOGNIZED THE NEED FOR FLEXIBILITY IN INFORMAL RULEMAKING PROCEDURES.

2/ 567 F.2D 9 (D.C. CIR. 1977).

3/ 564 F.2D 458 (D.C. CIR. 1977).

WITH THIS IN MIND, IT FELT THAT A BALANCING WAS CALLED FOR BETWEEN THE NEED FOR THAT FLEXIBILITY AND THE NEED TO PROTECT THE INFORMAL PROCESS FROM ABUSE. THIS FORMULATION WITH RESPECT TO EX PARTE CONTACTS IS ESPECIALLY NOTEWORTHY FOR US SINCE MANY OF THE NEW PROMOTIONAL FUNCTIONS COMMISSION EXERCISES MAY INDEED CAUSE PRIVATE INTERESTS TO COMPETE FOR A PARTICULAR, VALUABLE PRIVILEGE.

AS THE COMMISSION PROCEEDS TO FACILITATE THE ESTABLISHMENT OF NATIONAL MARKET AND CLEARING SYSTEMS BY WAY OF INFORMAL RULEMAKING, WE MUST BE VIGILANT THAT THE PROCESS UTILIZED IS ALWAYS PROPER AND APPROPRIATE FOR THE ISSUES TO BE RESOLVED. IN THE HOME BOX OFFICE CASE THE COURT POINTED OUT THAT THE OBJECT OF THE INFORMAL RULEMAKING PROCEDURE IS TO ESTABLISH A DIALOGUE BETWEEN AN AGENCY AND INTERESTED PERSONS SO AS TO MAKE CRITICISM OR FORMULATION OF ALTERNATIVES TO AN AGENCY'S PROPOSED RULES POSSIBLE.

AS PART OF THE PROCESS, AN INFORMED DIAGLOGUE MUST OPENLY BE ENGAGED IN AND ALL INTERESTED PERSONS MUST HAVE FULL OPPORTUNITY TO PARTICIPATE. SUCH PERSONS MUST ALSO TAKE ADVANTAGE OF THE OPPORTUNITY TO PARTICIPATE. TO ME, THIS UNDERLYING PRINCIPLE OF OPEN DISCUSSION AND OPEN DECISION MAKING IN A MANNER SUFFICIENTLY FLEXIBLE FOR AN AGENCY'S EXPERTISE TO BE UTILIZED, IS MORE IMPORTANT THAN THE SPECIFIC HOLDINGS OF THE HOME BOX OFFICE OR CHILDREN'S TELEVISION CASES.

THE NSTA IN THE PAST HAS BEEN AN ACTIVE PARTICIPANT IN MATTERS DIRECTLY AFFECTING ITS MEMBERS. I SINCERELY HOPE THAT IN THE FUTURE THE ASSOCIATION AND ITS INDIVIDUAL MEMBERS WILL CONTINUE TO LET THE SEC HAVE THE BENEFIT OF YOUR VIEWS CONCERNING OUR RULE PROPOSALS. OF COURSE, DIALOGUE IS TWO-SIDED. FOR THAT REASON, I AM GRATEFUL TO THE NSTA FOR GIVING ME THE OPPORTUNITY TONIGHT TO ADDRESS YOU ON MATTERS OF CONCERN TO ME AS A COMMISSIONER.

THE 1975 AMENDMENTS HAVE GIVEN THE SEC THE OPPORTUNITY AS WELL AS THE OBLIGATION TO ASSIST THE SECURITIES INDUSTRY TO IMPROVE UPON EXISTING SECURITIES MARKETS. BUT THESE SAME AMENDMENTS, AND OTHER DEVELOPMENTS IN THE LAW, HAVE MADE THE RELATIONSHIP OF THE SEC TO THE INDUSTRY WE REGULATE A MORE FORMAL ONE. IN ADJUSTING TO THIS CHANGING RELATIONSHIP, WE MUST GUARD AGAINST SUBSTITUTING ADVERSARIAL CONFRONTATION FOR COOPERATIVE SELF-REGULATION. THAT IS, THE COMMISSION CANNOT PERMIT OUR PROSECUTORIAL PROGRAMS TO PREDOMINATE OVER OUR REGULATORY AND DEVELOPMENTAL PROGRAMS. BUT IN COOPERATING WITH THE SROs, THE SEC CANNOT BE COOPTED BY THEM. THE COMMISSION CANNOT PERMIT OUR DEVELOPMENTAL PROGRAMS TO CLOUD OUR JUDGMENTS CONCERNING OUR PROSECUTORIAL AND REGULATORY PROGRAMS.

I HAVE LONG HAD A GREAT RESPECT FOR THE SECURITIES INDUSTRY. IF THE SEC DESERVES ITS REPUTATION FOR BEING A GOOD GOVERNMENT AGENCY, PART OF THE CREDIT GOES TO THE INDUSTRY IT REGULATES. THAT INDUSTRY, WHICH YOU REPRESENT, AND THE SEC ARE NOW AT A CRITICAL JUNCTURE. WE MUST RECOGNIZE THAT OUR RELATIONSHIP TO ONE ANOTHER AND THE INVESTING PUBLIC HAS CHANGED AND WE MUST RESPOND APPROPRIATELY AND CONSTRUCTIVELY TO THAT CHANGE.

ATTENTION IS BEING FOCUSED TODAY ON THE NEED FOR INCREASED CAPITAL FORMATION, AND THE IMPACT OF GOVERNMENT REGULATION ON INVESTMENT. IN ORDER FOR CAPITAL TO BE ATTRACTED INTO THE PUBLIC SECURITIES MARKETS INVESTORS MUST BELIEVE THAT THE SECONDARY MARKETS ARE FAIR AND HONEST. IT IS THEREFORE IMPORTANT TO THE HEALTH AND GROWTH OF OUR ECONOMY THAT THE PUBLIC HAVE CONFIDENCE IN THE INTEGRITY OF OUR SECURITIES MARKETS. IT IS THE MUTUAL RESPONSIBILITY OF BOTH THE SEC AND THE SECURITIES INDUSTRY TO DESERVE THE TRUST WHICH ENGENDERS SUCH CONFIDENCE.