



SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

The Honorable David A. Stockman  
Director  
Office of Management and Budget  
The Executive Office of the President  
Washington, D.C. 20503

Dear Mr. Stockman:

This is in response to your letter of October 1, 1981, requesting that the Commission re-estimate its expenditures during fiscal 1983 to reflect the President's recently proposed 12 percent cut in 1982 spending and the continuation in 1983 of that reduced funding level. At the same time, as your staff has requested, the Commission is taking this opportunity to set forth the program impact of the 1982 budget reduction. These matters have been carefully reviewed by the Commission, and all of its members concur in this letter.

In March, President Reagan proposed a fiscal 1982 budget for the Commission of approximately \$83 million dollars -- a 6.5 percent reduction in spending from the level proposed by the prior Administration. The additional 12 percent cut in expenditures now proposed for this agency will require a further reduction of \$9,940,000, resulting in a fiscal 1982 budget of approximately \$73 million. Attachment A sets forth estimated Commission spending, by object class, at the \$73 million level.

These numbers alone do not, however, fully reflect the profound impact which a cut of this magnitude, concentrated in a single fiscal year, will have on the Commission and its ability to discharge its present statutory responsibilities. We estimate that approximately \$6 million of the proposed cut can be implemented through reductions in non-personnel expenditures, which account for about 27 percent of the Commission's budget. The remaining \$4 million of the reduction must come from personnel savings. In order to achieve this goal, 400 people -- about 1 out of every 5 Commission employees now on-board -- will have to be

separated, either through voluntary attrition or involuntary reductions in force. As a result, Commission employment during fiscal 1982 will decline from 1,929 on the first day of the year to approximately 1,525 at the close.\*/

The consequences of this change in Commission resource levels will be far-reaching and will impinge upon our ability to discharge many of our statutory functions. These impacts are set forth, in some detail, on a program-by-program basis, in Attachment B. Some of them include:

- Sharp limitations on the number of corporate filings reviewed by the Division of Corporation Finance.
- The elimination of the review of filings in the Commission's regional offices; all filings will be required to be filed in Washington.
- The elimination of the periodic (not in response to complaint or inquiry) inspection of investment companies, broker-dealers, transfer agents, and regulated entities.
- Reduction by at least 15 percent in the enforcement program caseload, including immediately terminating some active investigations and abandoning certain pending litigation.
- Elimination of the Commission's office which responds to investor inquiries and complaints.
- Termination of the Commission's participation in private litigation as an amicus curiae and in bankruptcy proceedings involving public companies.

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\*/ On October 2, the Office of Management and Budget informed the Commission that its fiscal 1982 personnel ceiling would be 1,792. The proposed 12 percent spending reduction will, however, as noted above, necessitate far greater personnel cuts.

- Substantial reductions in the Commission's economic analysis capabilities and in its dissemination to the public of statistical data concerning the securities markets.
- Termination of the proposed, computerized Market Oversight and Surveillance System (MOSS).
- Closing or consolidation of several Commission regional and branch offices.
- Sharp reductions in expenditures which support the work of the professional staff, including telephone service, travel and training funds, reproduction and duplication, computer service, and stenographic contracts.

*the foregoing*

The Commission recognizes the critical importance of reducing federal spending, and is ~~not~~ prepared to implement these reductions. We believe, however, that there are important distinctions between the Commission and certain other areas of federal spending which should be borne in mind as spending cuts are allocated. *if necessary*

First, the Commission is primarily a law enforcement agency. It administers no grants, entitlement programs, or open-ended spending programs. The Commission does not subsidize any industry or business nor does it administer social spending programs keyed to inflation. Accordingly, the Commission's expenditures do not involve areas which the Administration has targeted for substantial curtailment.

Second, the Commission's costs are largely for personnel. While a 12 percent reduction in government-wide spending during 1982 will apparently reduce federal employment by about six percent, a 12 percent spending cut applied to the Commission's 1982 budget will compel us to reduce our employment by approximately 21 percent.

Third, the SEC is already thinly staffed and effectively managed. As described in Attachment B, since 1975, its staff has decreased, while the Commission's responsibilities and workload have grown dramatically. The chief impact of budget cuts will, therefore, be to directly reduce our ability to enforce the federal securities laws and to administer the corporate disclosure program which Congress mandated nearly 50 years ago.

Finally, the Commission is largely self-sustaining. As set forth in Attachment C, approximately 65 percent of the Commission's expenditures are offset by revenues reserved as a result of filing fees imposed under the Securities Act of 1933 and transaction fees for securities trading under the Securities Exchange Act of 1934. Congress could, with minor adjustments in these fees, recover the full cost of Commission operations. Fee increases of this nature would not, in our judgment, have any significant impact on the securities markets.

In summary, the Commission has established plans to implement a spending cut of the magnitude which the Office of Management and Budget has proposed. This reduction will have a major impact on the nature and level of the Commission's activities, the size of and morale of its staff, and its ability to perform certain statutory functions. While the Commission recognizes the importance of reducing federal spending, we believe it is important that you afford careful consideration to the substantial change which will occur during this fiscal year in the nature of the Commission's activities.

Attachments D through F set forth the information you have requested concerning our revised fiscal 1983 budget request. The Commission will, of course, be pleased to provide any further information which you require concerning that request or the other matters discussed in this letter.

Sincerely,

John S.R. Shad  
Chairman

Attachments: A --

B -- Program Impacts of Reductions Necessary  
for the Securities and Exchange  
Commission to Achieve a 12 Percent  
Spending Reduction in Fiscal 1982

C -- Graph entitled "Appropriated Funds v.  
Fees Collected"

D --

E --

F --

Attachment B

PROGRAM IMPACTS OF REDUCTIONS NECESSARY FOR  
THE SECURITIES AND EXCHANGE COMMISSION TO ACHIEVE A  
12 PERCENT SPENDING REDUCTION IN FISCAL 1982

Background

	<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>1982</u> (proposed)
Personnel on Board (year-end)	2,009	1,972	1,929	1,525

The Securities and Exchange Commission is charged with principal responsibility for the enforcement and administration of the federal securities law. These laws consist primarily of five statutes which reach every segment of the securities industry. The Commission's duties include the regulation of public offerings of securities pursuant to the Securities Act of 1933 and the trading in securities which are already issued and outstanding pursuant to the Securities Exchange Act of 1934. The Exchange Act also imposes disclosure and other requirements on publicly-held corporations; prohibits various manipulative or deceptive devices in connection with the purchase or sale of securities; requires brokers and dealers to register with the Commission and regulates their activities; and provides for Commission registration and supervision of national securities exchanges, clearing agencies, transfer agents, and securities information processors. The Public Utility Holding Company Act of 1935 requires Commission approval of the financings of electric and gas public utility holding company systems. The Investment Company Act of 1940 requires Commission regulation of the composition of the management of investment companies, approval of advisory contracts and changes in investment policy and transactions by such companies with directors, officers or affiliates. Finally, the Investment Advisers Act of 1940 establishes a scheme of regulation and registration of investment advisers.

The Commission is a small agency. At the close of fiscal year 1981, it employed 1,929 persons. The Commission's present staff level is lower than in any previous year since 1974. While staffing levels have declined, the securities industry has been subject to tremendous growth and activity. From 1974 to 1980, the average daily volume of trading on the New York Stock Exchange has risen from 14 million shares to 45 million shares, while average daily volume in the over-the-counter market has increased from 5 million to 27 million shares. During this same period, the number of registered broker dealers has risen from 3,982 to 6,751. In the investment company area, at year end 1974, 1,377 companies were registered with the Commission. These companies held assets with a market value of \$62 billion. By year end 1980, 1,591 investment companies were registered

holding assets with a market value of approximately \$156 billion. Finally, in 1974, 2,890 registration statements were declared effective involving approximately \$57 billion. In 1980, 3,263 statements were effectively registered representing approximately \$105 billion.

In addition to the increased activity in the securities markets, Congress has periodically increased the Commission's statutory responsibilities without affording increased staffing. For example, in 1975, Congress directed the Commission to facilitate the establishment of a national market system, and a national system for the clearance and settlement of securities transactions. These amendments also expanded the Commission's authority over all self-regulatory organizations and required formal Commission approval of all exchange rule changes. The amendments also set forth a comprehensive pattern for the registration and regulation of clearing agencies, transfer agents, bank and non-bank municipal securities dealers. In 1975, Commission staff numbered 1,935. By 1980, the staff had been reduced to 1,929.

Thus, Commission resources have decreased steadily in the past decade, while Commission statutory responsibilities, and the activities of the securities industry as a whole, have increased dramatically. The implementation of a 12% budget cut at this time will, therefore, substantially affect the operation of the Commission in all areas. The following is a description of each of the Commission's programs and the impact which would result from the 1982 budget cuts.

I. FULL DISCLOSURE

A. Overview

	<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>1982</u> (proposed)
Personnel on Board (year-end)				

The full disclosure program mission is to provide investors and the market place with material information concerning approximately 9,000 public companies in order to prevent fraud and misrepresentation in connection with the trading, voting and offering of securities. Full disclosure implements the statutory mandate of investor protection and thereby fosters confidence in the integrity of the nation's securities markets. Thus, full disclosure facilitates capital formation which is vital to the reindustrialization of American business and provides the framework for fair and orderly trading in securities markets. In 1980 alone, American industry made public offerings on 3,150 registration statements aggregating over \$100 billion in equity and debt securities and over \$600 billion in equity securities were traded in the market place.

Our nation's markets are the most efficient in the world because of full and fair disclosure. The principal means of assuring full disclosure is the review of disclosure filings to detect fraud before it occurs, rather than after the fact when remedial action becomes more costly and less efficient.

Because of current budgetary restrictions, review is being made only on a selective basis rather than review of every filing. The proposed reductions would necessitate elimination of even selective review in certain areas. A recent case exemplifies the high cost to investors and companies that can result from no staff review. In making a public offering, a company presented its financial statements in an incorrect and misleading manner. Since the registration statement was effective, the Commission's only recourse was a stop order proceeding after which the company's stock price fell by 50% resulting in the loss of thousands of dollars by investors. The ensuing efforts to resolve the matter after the fact involved hundreds of hours of staff time and that of the company. If the filing had been reviewed before the public offering, this time and expense could have

been avoided and the resulting private lawsuits by investors would not have occurred. Thus, the review process is cost efficient not only to the Commission, but to public companies and investors as well.

In addition to the Division of Corporation Finance which reviews the filings, the full disclosure program is implemented by the Office of Chief Accountant, which oversees accounting standards and by the Office of Applications and Reports Services, which performs the logistical functions related to the processing of filings.

## B. Impact of Reductions

### (i) Review of Filings

To appreciate the full impact of the proposed staff reduction on this function, one must understand that, since 1962 and prior to any of the proposed reductions, the number of reporting companies has more than doubled and the number of filings has increased three fold (from 18,335 to 57,000), while the staff charged with review of these filings has declined by 10%. In light of the number of filings and already limited staff, the proposed reductions would have significant consequences. Annual and other periodic reports (38,000 filed in fiscal 1981), the accuracy of which is critical to trading on exchanges and in the over-the-counter market, would not be reviewed. By not being able to review any proxy statements (6,500 in fiscal 1981), the staff would not be able to review any filings involving mergers and acquisitions (614 in fiscal 1981) or proxy contests (70 in fiscal 1981). For the first half of calendar year 1981, there were 1,184 transactions involving the transfer of 10% or more of the ownership interest of companies which aggregated \$35.7 billion. Included in these transactions are tender offers, which are of vital importance to the companies involved, their shareholders and the investment community. The staff would not be able to review these fast-moving transactions (205 in fiscal year 1981) in which a timely comment by the staff typically results in investor protection and avoidance of costly litigation. As to filings involving public offerings, the Commission will be able to review only about one-third of first time filings (1,400 filings in the headquarters office in fiscal 1981) even though "hot issues" markets which arise from time to time present difficult disclosure problems. No review would be possible for public offerings by companies which already report under the Exchange Act (2,823 in fiscal 1981), even though they can present novel and unique issues, particularly when an issue is approaching financial difficulty.



Moreover, the discontinuance of the review of filings by the regions (800 in fiscal year 1981) would require the headquarters office to process an estimated 1,000 additional filings in fiscal year 1982 with no increase in staff. The added burden of this transfer is demonstrated by the fact that 43 people currently review filings in the regions. Because regional filings are made by relatively inexperienced and unsophisticated companies, they are more in need of review to prevent fraud and misrepresentation. If the filings cannot be reviewed because of reduced staff, it is possible that many investors will purchase securities with misleading information and subsequently lose their investment. Although enforcement actions can be taken, as indicated above, this is not cost efficient. Moreover, one can expect an increased need for enforcement presence when less than one third of first time filings are reviewed. In addition, regional office filings have been highly praised by businesses and the legal and accounting professions as an effective way of assisting small to medium sized companies in solving some of their capital formation problems and of avoiding the expense of traveling to Washington.

Other related functions would also be impaired. The staff provides interpretive assistance to the public, companies and their counsel in the form of telephone requests (35,211 in fiscal 1981) and no-action and interpretive letters (1,548 in fiscal 1981). Under the proposed reduction, the staff would have to curtail this service by substantially limiting the matters which could be addressed. Rulemaking initiatives have been primarily deregulatory, focusing on simplification and reduction of burdens on companies, particularly small businesses. These deregulatory initiatives would have to either be delayed or deleted, resulting in continued high costs of regulatory compliance. Moreover, the SEC's five year program to "sunset" review disclosure rules to eliminate unnecessary and outmoded regulation would also be extended to ten years or more.

Incidentally, the Small Business Investment Act of 1980 mandates that the SEC host an annual conference with state securities regulators and an annual conference with other federal regulatory bodies and business leaders to develop ways to assist small business. Since Congress has not funded these conferences, their cost could not be recovered from other activities, given the wholesale reductions necessary to achieve the savings directed by the President. Thus, this Congressional initiative to improve the capital formation process would have to be abandoned.

(ii) Chief Accountant

At the revised staffing level under discussion for 1982, priority in the Chief Accountant's Office will be given to timely responses to registrant questions and assisting in accounting investigations. This emphasis would result in a reduction of the oversight and monitoring of the private sector standards which has traditionally enabled the SEC to rely on the private sector in fulfilling the SEC's statutory responsibility to prescribe the form and detail of financial statements. This reduction could result in inconsistent accounting and auditing standards and the possible necessity in the future for greater intervention by the SEC in accounting and auditing practices. The cost of such future action would outweigh that of the present oversight program. It would not foster the gradual evolution of uniform accounting and auditing standards which has historically occurred.

More specifically, the review of rules to effect reductions and simplification will either have to be discontinued or conducted at a reduced pace. While the degree of oversight of the accounting profession's new self-regulatory organization will be reduced, the Office will -- pursuant to an agreement between the profession and the Commission -- review a sample of peer review working papers to enable the Commission to form an opinion on the program and to place substantial reliance on the organization's internal mechanism for continuing oversight. The biggest impact will be in the area of oversight of the private sector's accounting and auditing standard-setting bodies. Substantially less attention will be devoted to monitoring these activities which could impair the Commission's ability to judge whether the nature and direction of these projects -- some of which could have a significant impact on financial reporting -- are appropriate.

(iii) Office of Applications and Reports Services

The proposed funding will require the Commission to abolish the Ownership Branch in the Office of Applications and Reports Services and rely on commercial supplies to make ownership data available to the Commission and to members of the public. This will reduce the availability and reliability of information provided on Forms 3 and 4, which discloses the security holdings and transactions of officers, directors, and owners of 10% or more of a public company's stock. By failing to identify persons who are delinquent in filing required reports and attempting to obtain them, the public will be

deprived of information vital to informed decision-making. A commercial supplier will, quite naturally, not have the authority to enforce a delinquency program. More importantly, certain insider trading profits and practices forbidden by the Securities Exchange Act of 1934 could occur without timely disclosure of information sufficient to enable affected shareholders to bring private derivative action.

## II. PREVENTION AND SUPPRESSION OF FRAUD

### A. Overview

	<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>1982 (proposed)</u>
Personnel on Board Division of Enforcement in Washington, D.C. (year-end)				
Personnel on Board Regional and Branch Personnel Devoted to Enforcement Activities (year-end)				

The enforcement program ensures integrity in the securities markets, offers protection to investors and supports the Commission's other regulatory programs. This law enforcement program is one of the most visible in the United States. It promotes investor confidence in the fairness and orderliness of our capital markets, and confidence in our nation's economic growth and stability.

The program is personnel intensive, utilizing lawyers, accountants, analysts, research assistants, investigators and support staff. The staff conducts investigations, and initiates and conducts civil and administrative proceedings. Also, the enforcement staff supports the securities law enforcement efforts of other federal and state law enforcement agencies and those of self-regulatory organizations.

Many governmental agencies and organizations depend upon the Commission's enforcement unit for vital support. The enforcement staff works with those organizations for which the Commission has oversight responsibility, including the national securities exchanges and the NASD. It supports the North American Securities Administrators Association and the respective state securities administrators. It works closely with the Criminal Division of the Department of Justice, the various U.S. Attorney's offices, other law enforcement authorities, as well as certain state regulatory agencies, rendering staff assistance where requested. Moreover, it works closely with other federal agencies as well as foreign and local authorities in order to coordinate enforcement activities of mutual concern. These agencies and organizations depend upon the Commission's enforcement staff for expertise and support.

At September 30, 1979, 1980 and 1981, the Commission was engaged in the following enforcement activities:

	<u>9/30/79</u>	<u>9/30/80</u>	<u>9/30/81</u>
Investigations	1,171	1,088	945
Civil Proceedings (excluding subpoena enforcement)	257	286	210
Administrative Proceedings	50	47	18

#### B. Impact of Reductions

By cuts in the enforcement staff's FY 1982 budget, the number of securities law violations pursued will be reduced and the ability to protect the integrity of the marketplace will be impaired. Furthermore, the ability to pursue violations without delay will be eroded. All of this will have a marked impact on the rate of successful prosecutions. The total effect will be a reduced Commission enforcement presence in the marketplace, and a diminution of the deterrent effect of such a presence.

The percentage of the workload reduction will be at least as great as the percentage of manpower reduction. This is true not only because of proposed FY 1982 budget cuts, but also by reason of (1) recent judicial decisions reflecting changing attitudes making the burden of proof greater in securities cases; (2) defense counsel employing more dilatory tactics and engaging in more litigation; and (3) non-programmatic legislative requirements, such as the Freedom of Information Act and Right to Financial Privacy Act, that impose procedural and manpower burdens and impede the ability of law enforcement agencies to work together.

One key aspect of the enforcement program is the ability to react rapidly to new and emerging securities law problems. This ability will be impaired by the proposed FY 1982 budget cuts. Another likely consequence of the reduction is that the staff will be less able to work on the difficult and tough cases. These cases include such core enforcement activities as "insider trading" and "manipulation." These are difficult violations to establish without extensive investigations.

With the current backlog of open investigations and pending litigation, the budget reduction means that the Commission must terminate active investigations of possible securities laws violations and abandon litigation in midstream. It may also be necessary to settle cases on less than satisfactory terms.

To begin such a process will have a lasting effect on the Commission's long-range investigation, litigation and settlement processes. Without excising certain of these pending investigations and litigation, however, the Commission will lose the ability to continue to pursue new problems which are called to its attention.

The reduction in staff by reason of the FY 1982 budget cuts will reduce significantly the vital support that the Commission's enforcement unit renders to other governmental agencies and organizations. These other organizations do not have the securities law expertise that the Commission's enforcement unit provides. Thus, their own law enforcement activities will erode.

The Commission's enforcement activities are recognized as playing an important role in the stability, growth and integrity of our capital markets. The Commission's law enforcement function is as important as any in our society. The Commission's ability to continue to perform this important function will be seriously eroded by the proposed FY 1982 budget cuts.

#### Office of Consumer Affairs and Information Services

The proposed budget will require the elimination of the office which responds to investor inquiries and complaints. The oversight of computerized data used to manage inquiries and complaints received from investors will also be affected. The oversight activity includes verifying the accuracy of case tracking information used for statistical analysis in support of enforcement examinations programs, and ensuring that paper files reflect the index information on the computer. It also includes the manual maintenance of production volume records used in the budget process and in special studies of Commission caseloads.

### III. REGULATION OF SECURITIES MARKETS

#### A. Overview

	<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>1982</u> (proposed)
Personnel on Board (year-end)				

The Commission is charged with overseeing the unique self-regulatory system for the securities industry administered by the securities exchanges and the NASD. That system provides maximum leverage of scarce governmental resources. In 1975, the Congress multiplied the Commission's explicitly mandated oversight responsibilities at a time when the securities industry was virtually exploding with record volumes and new products. From 1974 to 1980 the average daily volume of trading on the New York Stock Exchange has risen from 14 million shares to 45 million shares, while average daily volume in the over-the-counter market has increased from 5 million to 27 million shares. Options trading has increased from 5.5 million contracts in 1974 to nearly 97 million contracts in 1980. In addition, markets for new products such as forward and options contracts on debt instruments are rapidly emerging and bond market volume has increased enormously. The number of registered broker-dealers has more than doubled during this period to 6,751. Moreover, the 1975 amendments placed new classes of entities, including municipal securities dealers (350), transfer agents (935), clearing agencies (12?) and securities information processors under Commission regulation. Finally, the Congress charged the Commission with a new mandate for the establishment of a national market and clearing system, which would efficiently accommodate rapid trading growth and avoid repetition of the back office crisis of the late 1960's. The Commission's vigilance and effectiveness in assuring public confidence in our securities markets is widely recognized and essential to nation's economic recovery.

In order to fulfill our duties as market overseer, the Commission is involved in field examinations and continuous monitoring of the securities exchanges, the National Association of Securities Dealers, clearing agencies and transfer agents. Congress also requires the Commission annually to make statutory findings with respect to hundreds of rule change filings, including critical facilities improvements necessary to achieve market efficiency and reduce execution costs and important new securities products essential to industry growth and profitability.

#### B. Impact of Reductions

Despite the recent dramatic increase in trading volumes and products, the number of Commission staff dedicated to market

regulation has remained relatively unchanged and, in the last two years, has actually declined by 15%. The staff reduction required to achieve a further 12% budget savings will severely limit Commission performance of its market regulation activities.

(i) Oversight

Audit inspections of the securities exchanges and the National Association of Securities Dealers, particularly in the areas of their market surveillance capacity and their member firm financial surveillance, require frequent field examination and continuous monitoring. Pursuing these inspection activities into longer multi-year cycles undermines effective oversight. Less than 50% of the nation's market facilities will undergo field examinations this year. In addition to these SROs, in 1975 the Congress extended the Commission's direct regulatory responsibilities to clearing agencies and transfer agents. As recent events in the Denver "hot issue" market confirm, failures by these entities can seriously disrupt and imperil the securities markets. Commission oversight in these new areas is severely limited now, before the 1982 cuts go into effect.

The Commission's broker-dealer oversight program is primarily conducted at the local level by its regional offices. Substantially reduced examination capacity will dilute Commission oversight of SRO monitoring of the financial condition and regulatory compliance of securities firms. Moreover, when difficulties arise, such as the Paine Weber and Bache crises in 1980 and the Muir and Wien failures this year, substantial Commission involvement is essential to assure that the public is protected and other firms are not endangered. In addition, the Commission must directly monitor firms that are not SRO members and must examine transfer agents which are registered with the Commission. The impact of the proposed budget cut in this latter area would mean the cessation of all routine inspections of SECO brokers and transfer agents.

In regard to rule change filings with the Commission, such vital industry initiatives will be delayed months and, in some cases, years. In excess of 60% of all filings will be delayed beyond the statutory review period.

In addition to impairing the Commission's efforts to ensure the integrity of the marketplace, the proposed staffing reductions will further delay a number of regulatory reform initiatives designed to reexamine existing regulations in light of changing market conditions, to revise or remove regulatory requirements no longer deemed necessary, and to refine the regulatory framework to promote greater capital



formation while at the same time affording adequate protection for public investors. Activities which will have to be delayed or deferred include comprehensive revision of the Commission's financial responsibility rules and reexamination of trading practice rules.

(ii) Market Oversight and Surveillance System (MOSS)

On October 1, 1981, the Commission delivered its second six-month report on MOSS to the Congress, pursuant to Congressional direction in the Commission's budget authorization for 1981-83. The MOSS proposal was developed to apply automated surveillance techniques in conducting the Commission's traditional oversight function over the securities markets. The report also discusses a recent initiative by the self-regulatory organizations to establish an inter-market surveillance program (including an NYSE audit trail) which, if successfully implemented, would render direct Commission surveillance capability largely duplicative. Accordingly, while continuing the MOSS pilot program in 1982, the Commission did not plan on additional resources in 1983 to enhance MOSS beyond the pilot.

The additional budget reduction proposed for 1982 will require complete elimination of the MOSS program. That action will effectively remove the option of a direct Commission role should the self-regulatory initiative prove infeasible. Accordingly, the Commission will be left without market oversight capability deemed essential by the Congress.

(iii) Office of Applications and Reports Services

The proposed budget reductions will eliminate the ability of this office to examine amendments to broker-dealer and transfer agent applications. The information resulting from these reviews is used by the public, self-regulatory organizations, and the Securities Investor Protection Corporation.

#### IV. PUBLIC UTILITY HOLDING COMPANY REGULATION

##### a. Overview

	<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>1982</u> (proposed)
Personnel on Board (year-end)				

The Public Utility Holding Company Act of 1935 ensures that interstate public utility holding companies engaged in the electric utility business or in the retail distribution of gas operate as functionally integrated utility systems with sound financial structures. To uphold the public interest from the investor and consumer viewpoints, the Act requires the Commission to regulate financial and other business decisions of registered companies and their subsidiaries. Such business decisions include company structure, scope of operations, internal prices charged between system units, external financing, mergers and acquisitions, and outlays for fuel exploration and development.

The Commission regulates a sizable segment of the entire utility industry, specifically 24% of all electric utility assets and 8% of all gas utility assets for a weighted total of 20% of all electric and gas utility assets. Measured by revenues, the 13 current systems include the two largest electric utilities in the country. Within the systems there are 55 utility subsidiaries, 68 non-utility subsidiaries, 22 inactive companies, and 12 service companies, aggregating \$55 billion in net system assets and \$23.5 billion in gross system revenues in 1981.

##### B. Impact of Reductions

The proposed budget reductions will cut in half the size of the staff devoted to this program. At reduced staff levels, the Commission will not be able to handle current workload matters while addressing ways to process future increases in regulatory filings anticipated after 1983, when energy conservation efforts may be exhausted and tight financial markets are expected to be eased. To accommodate emergencies like Three Mile Island or to prepare hearings upon application by consumer groups or utility systems, the Commission at reduced staffing levels could give only cursory reviews to serious regulatory filings and fuel company applications. The resulting reduced oversight of utility systems would then call into question the policy of not inspecting subsidiary service companies and cause the Commission to become an increasing Federal burden to utility companies struggling to meet the nation's energy needs.

## VI. LEGAL SERVICES

### A. Overview

Personnel on Board (year-end)	<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>1982</u> (proposed)
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The Office of General Counsel serves as the Commission's attorney. The Office's responsibilities include: (i) representing the SEC in all appeals from enforcement matters in the U.S. Courts of Appeals and the Supreme Court (\_\_\_\_ briefs were filed in fiscal 1981); (ii) defending the Commission in all civil actions brought against the SEC or its staff (23 actions were brought last year, a dramatic increase); and (iii) administering such non-SEC statutes as FOIA and handling hearings and appeals with respect to personnel actions (10% of the Office's time is spent on FOIA matters which included last year's requests - over 1,800 - as well as appeals of rulings - 180). The discretionary work involves: (i) participating amicus curiae in private litigation to protect the SEC's enforcement interests as well as the public's (30 briefs were filed last year); and (ii) coordinating the Commission's legislative program and providing objective oversight of other limits to assure a consistent approach adhering to Commission policies.

The principal functions of the Office of Opinions and Review in this program are the preparation of quasi-judicial opinions for the Commission on appeals stemming from its own administrative proceedings. These are usually prosecuted by the Division of Enforcement before the administrative law judges or by self-regulatory organizations, mostly the National Association of Securities Dealers. The Office of Opinions and Review also prepares a variety of other documents, such as pre-argument memoranda, orders disposing of motions for stay, and orders granting petitions for review of initial decisions of an administrative law judge.

The Commission's legal services program also includes the bankruptcy program and the administrative law judges. With respect to bankruptcy, the recognized tradition of expert service rendered by the Commission in corporate reorganizations was reaffirmed by Congress in the Bankruptcy Reform Act of 1978, which includes special provisions authorizing the Commission to appear and raise issues in any corporate reorganization case. Since October 1, 1979, the Commission's staff has appeared in 36 of the 123 reorganization cases filed by public companies. Those cases involved about \$4 billion in total assets and about 230,000 public investors.

The Commission's administrative law judges are responsible for the adjudication of Commission administrative proceedings, including broker-dealer disciplinary proceedings and similar enforcement proceedings.

B. Impact of Reduction

(i) Office of the General Counsel

Most of the work of the Office is non-discretionary. Appeals must be answered and suits defended. Thus, the proposed 18% reduction of its staff would have to be absorbed in its discretionary programs, with the result that filing of amicus curiae briefs would be sharply curtailed and counseling and legislative activities reduced.

Amicus

Since 1946, the Commission has participated in selected private litigation in the federal courts. In 1981, for example, amicus briefs were filed. As a result of the proposed budget reduction, this program would be largely eliminated.

The Commission participates amicus in three circumstances. First, the Commission has normally honored a court's request to express its views in a particular case. Such requests have been made by the Supreme Court and courts of appeals, and, occasionally, by district courts. The Supreme Court frequently requests the Commission's views as to whether certiorari should be granted in private actions involving securities laws issues and it would be a serious matter if the Commission were not able to accommodate the Court.

Second, and by far the largest category of private cases in which the Commission has participated amicus curiae, are cases where the issues being litigated may have an impact, directly or indirectly, on the Commission's own regulatory or enforcement responsibilities. The federal securities laws are one of the few bodies of law in which issues arising in Commission and private litigation can affect each other dramatically. For this reason, important issues in private cases should not be resolved without the Commission seeking to influence the outcome.

The third general category of cases in which the Commission has participated amicus curiae include cases which raise the issue of whether a private cause of action exists under a particular provision of the securities laws, or questions relating to the requisite elements or other aspects of such suits. The Commission has participated in such cases because it views private actions under the federal securities laws as a necessary supplement to its own enforcement actions and as a needed means of redress for injured investors.

### Counseling

The counseling group in the General Counsel's Office is the only separate staff unit within the Commission which attempts to provide the Commission with advice on the Commission's programs as a whole. This group furnishes legal and policy analysis necessary for in-depth consideration of important matters, including particular cases (e.g., sensitive enforcement investigations), major rulemaking (e.g., jurisdictional or other issues) and proposed legislation (e.g., bills to amend margin provisions of the Securities Exchange Act of 1934 regarding foreign takeovers). The counseling group also works on such inter-agency efforts as last year's study of the government securities markets and assists the Chairman's Office in connection with special projects. Finally, the counseling group advises other staff units on compliance with administrative laws applicable to the Commission (e.g., Regulatory Flexibility, Sunshine, Paperwork Reduction and Right to Financial Privacy Acts).

The proposed cutbacks in the counseling function will severely reduce the ability of the Commission to initiate and coordinate agency-wide programs for deregulation by either legislative or regulatory change. Further, the Commission would be deprived of the advice of its independent counsel on major regulatory matters. This would make it much more difficult for the Commission to reach a considered resolution of difficult legal and policy issues, especially where staff views differ. The net effect would be a serious impairment of the Commission's capacity to respond to changes in the marketplace and regulatory environment.

#### (ii) Office of Opinions and Review

To implement the proposed 12% cut, the Office will be abolished. In sum, the impact of the abolition of the opinion-writing office will impose an increased workload on

the commissioners and their legal staff, who may be unable, because of their other responsibilities, to devote the time and attention necessary to the preparation of these types of reviews.

(iii) Bankruptcy

The proposed elimination of 34 of the 38 personnel engaged in the corporate reorganization program will severely curtail the Commission's traditional role in corporate reorganization cases. In reorganizations involving large public companies, the Commission will, of course, continue to involve itself, where resources permit.

(iv) Administrative Law Judges

Staff reductions required to implement the 12% budget cut in 1982 will necessitate reducing the Commission's Office of Administrative Law Judges by four, from the 10 personnel currently on board to six. As a result, the time interval required to hear cases and issue decisions will be considerably impaired as the remaining judges struggle to address the larger workload per person.

## VI. INVESTMENT MANAGEMENT REGULATION

### A. Overview

Personnel on Board (year-end)	<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>1982</u> (proposed)
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The mission of Investment Management Regulation is to achieve investor protection in the investment community and investment advisory industries. The assets of investment companies, unlike those of industrial companies, are securities, and generally highly liquid. As a consequence, the potential for abuse and manipulation by controlling persons and their affiliates is greater, in the absence of appropriate regulation, than for other types of companies. Similarly, investment advisers manage clients' funds as well as give advice with respect to investment in securities. Abuses, such as manipulating funds entrusted to them and providing investment advice without disclosure of the adviser's self-interest, have been not infrequent in this area and have required a high degree of surveillance. In order to remedy abuses relating to investment management activities, Congress enacted two comprehensive regulatory statutes: the Investment Company Act and the Investment Advisers Act. Effective administration of these two statutes requires that the program continue to conduct a number of activities, particularly in view of the rapid growth of these industries.

There are presently some 1,500 registered investment companies with more than 15 million shareholders, and assets of over \$250 billion. This represents a 13% increase in the number of companies, a 50% increase in the number of shareholders, and a 310% increase in the value of assets over 1977 levels. Money market funds, which have come into widespread prominence in the last four years, account for more than \$160 billion of net assets. In this regard, it is likely that many investors in money market funds are individuals who have never before invested in securities. The degree to which the Commission can maintain proper oversight over money market funds could make the difference between these individuals becoming regular investors in the nation's capital markets in the future, on the one hand, or being discouraged from ever again investing, on the other hand.

The 5,100 registered investment advisers serve approximately 1.5 million clients and manage assets of over \$450 billion. Since 1977, the industry has witnessed a 6% increase in the number of advisers, an 80% increase in the number of clients, and a 20% increase in the value of assets.

While these industries have grown rapidly and are expected to continue to do so, the number of staff responsible for these activities has actually decreased, approximately 10%.

#### B. Impact of Reduction

##### (i) Inspections

Inspections of investment companies and investment advisers are conducted for cause whenever it appears that violations of the law may exist. In addition, the Commission has heretofore conducted a cycle of routine inspections in order to detect and deter violations. The proposed budget cuts would remove 24 people from the program at both the regional offices and headquarters, thus necessitating the elimination of all routine inspections of investment companies (except money market funds) and investment advisers. While the program would, of course, focus its remaining resources in those areas in which inspections are most important, the elimination or even curtailment of routine inspections could have several adverse consequences. First, regular inspections can uncover violations of law at an early stage and thereby forestall later, more serious problems that could harm investors and require expensive enforcement proceedings to remedy. Second, cutting back on the number of inspections will reduce the amount of money recovered for investors, which totaled approximately \$12.5 million during the past five years. Finally, when investment companies become aware that the Commission can no longer perform routine inspections, the deterrent effect of the Commission's oversight could markedly decline.

##### (ii) Regulation

Implementation of the proposed cuts will eliminate a total of 11 people from this activity: two from processing exemptive applications, three from responding to no-action and interpretive requests, and six from rulemaking. The Commission is statutorily mandated to consider applications for exemption from the regulatory provisions of the Investment Company and Investment Advisers Acts. The result



of the proposed cuts will be to lengthen processing time, thereby impeding the ability of investment companies to engage in what might be reasonable business transactions which would benefit their investors. The staff has undertaken for many years to respond to requests for interpretive advice, and regulated entities and their counsel rely heavily on the guidance provided by the staff. The importance of such guidance has increased in recent years, as the growing complexity and sophistication of investment vehicles made available to the public has led to more complicated questions under the federal securities laws. The no-action and interpretive function is not statutorily required, however. If the proposed budget cuts are implemented, the program will respond only to requests for no-action and interpretive advice that raise issues of industry-wide significance. This procedure will adversely affect those companies whose questions relate only to their unique circumstances. At a minimum, such companies will have to incur increased legal fees in the absence of a statement of the staff's position, and where the question is particularly difficult it might not be possible to proceed prudently with the transaction.

The Division of Investment Management has undertaken comprehensive reviews of the regulatory and disclosure systems applicable to investment companies and investment advisers that are intended to provide exemptive relief from statutory restrictions and reduce the costs and burdens of regulation. A decrease in staff resources allocated to the aforementioned regulatory reform activities of approximately 40% is necessary for the program to continue to perform legally required and otherwise indispensable functions at a minimally acceptable level. This cut would result in the suspension of the Investment Advisers Act Study and would delay development and implementation of deregulatory initiatives affecting investment companies. Deferral of deregulatory projects already begun would, in effect, postpone savings which would otherwise be realized by investment companies in the costs of complying with the securities laws.

(iii) Disclosure

Under the securities laws, the Commission is responsible for the review of registration statements and disclosure documents that are filed with the Commission and supplied to investors by investment companies. This review serves to prevent misleading disclosures and other violations of law that would otherwise have to be remedied by enforcement action and helps to maintain high standards of disclosure throughout

the industry. Under the proposed budget cuts, four people would be eliminated from this activity. Such a reduction would result in a 25% decrease in the number of investment company disclosure filings which could be reviewed.

(iv) Office of Applications and Reports Services

The 1982 reductions will require this office to stop examining applications for investment adviser registration and amendments thereto. Review of these filings is important in order to detect deficiencies at an early stage before they develop into serious violations of law. In this regard, 25% of investment adviser registrations are returned because of deficiencies. The information in filings by investment advisers is not only used by the Commission for its own regulatory purposes but, to a great extent, is relied on by the general public. Therefore, it is vital that the information be accurate and current. Suspension of review of these filings will result in the Commission's being unable to prevent violations before they occur. Remedying these violations later will in many cases require expensive enforcement proceedings or private litigation.

VII. ECONOMIC AND STATISTICAL RESEARCH

A. Overview

	<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>1982</u> (proposed)
Personnel on Board (year-end)				

The Commission's Directorate of Economic and Policy Analysis monitors Commission's rules, analyzes the securities industry's financial experience, and focuses upon major areas of concern to the industry and the Commission. It publishes annually The Staff Report on the Securities Industry and The Monthly Statistical Review.

The work of the Directorate is especially critical to the Commission's ongoing efforts to reduce regulatory burdens. The Directorate is responsible for various Commission programs to monitor the impact of existing Commission rules in order that appropriate modifications or elimination of rules can be considered. The Directorate is also engaged in a pilot effort to assess the costs and benefits of certain aspects of the federal securities laws and the Commission's rules thereunder. Moreover, the Regulatory Flexibility Act requires the Commission to assess the impact on small entities of certain rules.

The statistical collection and publication activities of the Directorate provide the public with information widely used in measuring and analyzing trends in the securities industry and the markets. In general, these materials are made available to the public on a subscription basis through the Government Printing Office. The fact that many in the industry and general public are willing to pay to receive these publications, demonstrates their utility.

B. Impact of Reductions

A 45% staff reduction in the Directorate of Economic and Policy Analysis is necessary to achieve the required 12% savings. This cut will require: (1) elimination of virtually all statistical collection and processing; (2) ceasing publication of the Monthly Statistical Review, which contains data relied upon by other agencies and the general public; (3) termination of programs to monitor the impact of Commission rules, other than the ongoing monitoring of Rule 19c-3, which permits over-the-counter trading

of certain securities also listed on exchanges; (4) either complete elimination of the annual "Staff Report on the Securities Industry" or a major reduction in its content; and (5) reduced ability to support the major divisions by providing impact analyses of proposed rule changes.

These reductions in the capabilities of the Directorate to serve the needs of the Commission with regard to economic analysis will be compounded by concurrent reductions in data processing capacity. As a result, the Directorate will be unable to provide more than a minimum of economic input to the policy issues which confront the Commission. Pending legislation which would impose additional regulatory analysis requirements on independent agencies will, if enacted, further limit the ability of the Directorate to perform its traditional role at the Commission.

VIII. PROGRAM DIRECTION

a. Overview

Personnel on Board (year-end)	<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>1982</u> (proposed)
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Program direction encompasses the policy-making, resource management, and administrative support functions of the Commission. Agency policy is formulated by the five-member commission which meets in formal sessions several times each week. In 1983, over 1,100 different matters will be considered in the course of approximately 115 meetings. Records of Commission meetings are made and maintained by the Office of the Secretary and access to information about Commission decisions is provided for the news media by the Office of Public Affairs. Also, the Chairman of the Commission has under his direct control the Offices of Internal Audit, Equal Employment Opportunity, and Legislative Affairs.

The Executive Director's Office supervises the management of the SEC personnel, financial information, and equipment resources. By providing internal organizational planning and consulting, formulating budget strategy, coordinating budget execution, and overseeing the development and use of computer systems, the Executive Director's staff works to ensure that all of the Commission's resources are expended effectively. The Executive Director is also responsible for directing the management of various administrative support offices, as well as the Office of Consumer Affairs and Information Services, and the Office of Applications and Reports Services.

b. Impact of Proposed Reductions

(i) Executive Staff

The staffing reductions contemplated for 1982 will have a substantial effect on the staffs of the chairman and the four other commissioners. While executive staff size will decline, the commissioners will be required to assume responsibility for drafting the Commission's opinions, a duty now vested in the Office of Opinions and Review. The internal audit unit will be abolished. The Equal Employment Opportunity Office will be merged into the Office of Personnel. The Commission's legislative affairs staff will also be reduced.

(ii) Secretary (including Library)

The elimination of four positions in this office during 1982 will limit the ability of the library staff to disseminate information concerning important legal and legislative developments to the Commission's professional staff. The Commission will also be compelled to terminate its efforts to reduce costly Federal Records Center storage problems by microfiching Commission minutes, exhibits and indices.

(iii) Executive Director

This office will be cut by four staff positions. This reduction will eliminate coordination for the Market Oversight Surveillance System; the Presidential Management Intern Program; and will reduce the management analysis capability by one-third.

(iv) Comptroller

Four personnel will be eliminated in this office. Those reductions will cause delays in depositing checks received, especially during peak filing periods, resulting in lost revenue to the government; cause occasional delays in report preparation, employment verification, and employee payroll problem resolution; and delay the payment of vouchers for Commission purchases.

(v) Office of Personnel

The training function will be abolished and dispersed among the various divisions and offices. By having centralized training, the Commission has been able to provide coordinated, Commission-wide, in-house training and develop internal training expertise and a cooperative working relationship with other federal agencies. Most of those advantages will be lost or sharply reduced where authority and responsibility to formulate and administer training policy is delegated.

(vi) Information Systems Management

Elimination of eight positions will result in abolition of the ADP liaison program which provides timely resolution of problems involving the use of a wide range of Commission data processing services. In addition, it will be necessary to reduce computer operations from 17 hours per day to approximately 12 hours per day.

Reduction in the non-personnel costs of \$935,000, which support computer operations at the Commission, will result in greatly diminished services to users in the form of elimination of teleprocessing capabilities currently available, elimination of user services currently purchased from commercial vendors, elimination of DEPA remote computing capability, and an inability to take advantage of hardware and software productivity aids.

(vii) Administrative Services

No transportation will be provided between the current three Commission locations in Washington, D.C. This means that staff time required to travel between the agency's three headquarters buildings will increase. Elimination of messenger service will require that each division and office arrange for its own pick-up and delivery of mail through the Commission's consolidated mail room, thereby slowing delivery of important and often time-sensitive reports and filings. Building maintenance will also be reduced.

(viii) Public Affairs

The reduction of three personnel will result in the cessation of all internal employee publications, an end to the agency's successful foreign visitors program, elimination of special press packets, and less frequent publication of the Commission's News Digest.