REMARKS OF THE HONORABLE JOHN D. DINGELL
BEFORE THE SECURITIES INDUSTRY ASSOCIATION
ANNUAL GOVERNMENT RELATIONS MEETING
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This is not a speech about how liquid and strong the Nation's securities markets are, bestowing kudos on you for a job well done.

This is also not a speech in praise of the integrity of the securities industry, dismissing you to go off to cocktails and continue as before.

That speech would be the equivalent of a father turning the keys of his shiny new Porsche over to a son who had over the last three weeks totalled the family wagon and RV, flunked two courses, and broken curfew every other night.

Accordingly, these remarks are about the events of this past year which threaten the very fabric of your industry. The U.S. Attorney has indicated in public remarks that their criminal investigation goes beyond insider trading to other violations of the federal securities laws. This is a chilling and disturbing revelation.

Regulation in the securities business is fundamentally different from that in other industry segments regulated by federal independent agencies: The SEC is not only a direct regulator but also a supervisor of self-regulators, the various exchanges together with the NASD. You, the member firms, are the first line of defense. But, in light of recent events, one must ask: "Quis custodiet ipsos custodes?" -- Who watches the watchdogs?

Let's talk about corporate takeovers.

Your critics contend that you are "churning" corporate America. Any truth to this?

The November 24, 1986 Business Week special report revealed:

> Nothing has fattened investment banks' bottom lines more than the takeover game. An investment banking team can bring in $10 million or $15 million at a pop for a couple of weeks spent advising on a major deal. Despite a steady undercurrent of grumbling from CEOs, the M&A advisory business has been spared the price-cutting generally rampant on the Street in recent years.
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> This lucrative specialty is dominated by an oligopoly of "M&A factories" -- elite departments that form one of the linchpins of the new Wall Street technostructure. In 35% of the more than 400 transactions of at least $100 million in 1985, the corporations involved hired one of three firms -- First Boston, Morgan Stanley, or Goldman Sachs. And 57% of the time, one of the seven top firms got the assignment, according to First Boston.

> As deregulation has whittled to the bone commissions charged for trading stock and underwriting blue-chip corporate bond issues, M&A income has become the life-blood of the top investment banks. Morgan Stanley & Co. is one of the Street's top five underwriting houses, but last year its prolific M&A unit produced $300 million of the firm's total investment banking revenues of $424 million and one-third of its total operating revenues. Yet only 120 of Morgan's 5,000 employees work in M&A.

You are also engaging in "merchant banking" by offering clients short-term "bridge" loans in order to win their business. First Boston agreed to make a short-term loan of $1.8 billion to Campeau to cover the entire purchase price of the Allied block it bought through Jeffries. Shearson Lehman Brothers offered to put up $1.6 billion to back a rival offer for Allied. Merrill Lynch & Co. committed to lend $1.9 billion to Sir James Goldsmith for his offer for Goodyear Tire & Rubber Co. which was never consummated; greenmail was paid for Goldsmith's 11.5% stake. Making yourselves active equity and debt participants in deals for your own account exacerbates the misuse of inside information and raises the same concerns you raise about combining banking and underwriting in the Glass-Steagall context.

Furthermore, there is a close working advisory relationship between the M&A unit and the arbitrage department, all creating serious conflicts of interest and temptations beyond belief. Martin Siegel, the central figure in the latest scandal, had been the head of his firm's M&A unit and the nominal head of the arbitrage department. If any Chinese wall existed, it ran down the middle of his navel. Call me a cynic, but that doesn't inspire my trust and confidence in the way you do business.

To me, the law on insider trading is clear at its heart and we all understand what Rule 10b-5 prohibits. So apparently did your colleagues who saw fit to conduct their trading offshore under assumed names and exchange suitcases of cash for nonpublic information in alleys. I see no need to define insider trading further at this time and give fertile legal minds opportunities to exploit loopholes.

I do however see a need to increase your incentives to clean up your business practices and strengthen your supervisory practices.

Currently, Section 20 of the Exchange Act provides firms with a defense to joint and several liability for an employee's defalcations if the firm can prove (1) good faith, and (2) that it did not directly or indirectly induce the violative conduct. Rule 14e-3, implementing the Act's provisions on fraud in connection with tender offers, gives you a defense if you show that (1) you did not know the material, nonpublic information, and (2) you "implemented one or a combination of policies" commonly referred to as "restricted lists" and "Chinese Walls" to

restrict trading in takeover stocks and the flow of such information. The Insider Trading Sanctions Act limits firm liability for the ITSA's treble penalty unless the employee's illegal trading results in a proprietary benefit to the firm.

Clearly, the Congress needs to and will revisit these provisions this year. Chinese Walls did not keep the Mongols out of China and they are not serving you well either. It is also unclear how much supervising is going on up on Wall Street. And I am unwilling to foist the blame off on recent pimply-faced MBA graduates.

The Reagan Administration came into town in 1981 talking about deregulation and "getting government off America's back." Everybody started playing with the nets down and ignoring rules they did not particularly like. Sad to say, many of our federal regulators took up "selective enforcement" and regulatory repeal of our federal legal system. The crooks let out a collective "whoopee." Lawlessness crept in to replace our ethical fabric. Morality and laws became commodities to be traded away for "an edge," "an advantage" and weighed on a cost/benefit scale against the bottom line. Some business and law professors were and are still teaching that insider trading contributes to liquid, efficient markets and should be legalized. In the middle of the Iranian scandal, when quizzed about goings on in the basement of the White House, former Merrill Lynch CEO and departed Reagan Chief of Staff Don Regan snapped: "Does the bank president know when the teller is fiddling with the books? -- No!" Well, securities industry you had better make it your business to know. It looks like some of you put up sentry posts on the border between your M&A units and arbitrage departments so as to qualify for your Exchange Act defenses but forgot to staff the posts or set up a vigorous duty roster. And don't bother telling me "Dingell, it can't be done" because, if you don't immediately set to putting your houses in order, it will be done for and to you. I really don't think you want a federal cop on top of every one of your computer terminals.

The Committee is looking into these matters now and you can expect legislation in this Congress to shore up the self-regulatory system, increase penalties for failure to supervise, establish appropriate coordination throughout the system, and assure the SEC the independence and resources to do a better job of regulating and enforcing.

It is no secret that your troubles are causing great glee in the banking community. Citicorp et al. are waiting for you guys to destroy yourselves so they can pick up the pieces. Only you can save yourselves. You are sure making my job of preserving a strong, independent securities industry a whole lot more difficult, if not impossible. I do not want to preside over a repeat of 1929.

We will also be holding hearings on program trading later this year. I know that you are all aware of our interest and concerns in this area. As most of you know, we also have opened inquiries with respect to the SEC's investigation and report on the 1983 Washington Public Power Supply System bond default, the increase in broker-dealer complaints relative to churning and other securities-law violations, and the pending Supreme Court decision concerning arbitration. The SEC's internationalization report is due to be delivered to the Committee in late spring/early summer. Hearings will be scheduled on these issues at the appropriate time. I think you can pretty well kiss RICO repeal or reform goodbye: if anything, it will be enhanced as you remain under fire.

I appreciate your attentiveness to my comments and urge you to work with the Committee and the rest of the Congress on responsible tender offer reform legislation and other matters of concern. It is to your benefit that you restore public trust and confidence in your industry. Markets run only secondarily on money. Public trust and confidence are the key to your past and future success.