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STATEMENT OF JOHN SHAD,
CHAIRMAN OF THE SECURITIES AND EXCHANGE COMMISSION,
BEFORE THE SENATE SUBCOMMITEE ON SECURITIES

CONCERNING THE COMMISSION'S AUTHORIZATION REQUEST
FOR FISCAL YEARS 1988-90

MAY 13, 1987

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I. Introduction

Chairman Riegle and Members of the Subcommittee:

The Securities and Exchange Commission appreciates this opportunity to present an overview of its fiscal 1986 activities and its ongoing efforts. This statement also discusses the Commission's authorization request for 1988 - 1990. It is requested that the separate statement setting forth the SEC's 1988 - 1990 authorization request, submitted to this Subcommittee on April 9, 1987, be included in the record.

In fiscal 1986 the Securities and Exchange Commission increased investor protections and reduced unnecessary paperwork and other expenses, ultimately borne by investors. Highlights include:

Record results or the highest levels of performance in years were achieved by all Divisions (see table below). Over the past five years, through automation, paperwork reduction and other staff and Commission initiatives, the increase in the Commission's results has compared favorably to the growth in the marketplace.

For example, since fiscal 1981:

- Enforcement actions have increased 63%.
- Full disclosure filings by issuers have increased 35%. SEC reviews of these filings have increased 71%.
- The number of registered broker-dealers has increased 57%. SEC broker-dealer oversight examinations have increased 73% and Self-Regulatory Organization inspections 83%.
- The number of registered investment companies and advisers has increased 86%. SEC inspections have increased 155%.
- The number of shares traded on the New York Stock Exchange has increased 186%, but the number of transactions has increased only 53% because of the growth of large transactions by institutions and others. The number of investors has increased 46%.
- Complaints to the SEC have increased 55%. Since 1982 all are reviewed. Most involve brokerage back office matters. They are referred to the firms' compliance departments for investigation and written response, and are tracked by the SEC through resolution. Others are referred to the SEC Enforcement Division, the Justice Department, Self-Regulatory Organizations or state securities commissions for investigation and prosecution if warranted.

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	Fiscal Years Ended September 30th						1981-86
	1981	1982	1983	1984	1985	1986	Change
Litigation ≠	121	141	161	176	153	179*	+48%
Enforcement Actions	191	254	261	299	269	312*	+63%
Filings Reviewed	6,153	6,239	6,987	7,237	9,571	10,526*	+71%
Broker-Dealer Oversight Exams	278	249	324	389	447	481*	+73%
SRO † Inspections	12	19	18	20	21	22*	+83%
Invest. Co. and Adviser Inspections	748	1,065	1,085	1,334	1,606	1,906*	+155%
Auth. Posns.	2,021	2,021	2,021	2,021	2,046	2,080*	+3%
Staff Yrs.ø	1,982	1,881	1,921	1,885	1,940	1,898	-4%
Budget (000,000)	$80.2	$83.3	$89.7	$94.0	$106.4*	$106.3#	+33%
Fees as a Percentage of Budget	81%	94%	110%	129%	135%	203%*	

* A record or the highest level in years.

≠ Cases litigated by the Office of the General Counsel, amicus positions, civil subpoena responses and bankruptcy appearances.

† Self-Regulatory Organization.

ø Authorized Positions and actual Staff Years. The differences are due primarily to budgetary constraints and also to government-private sector wage disparities.

\# After a $4.8 million reduction from the $111.1 million appropriated due to Gramm-Rudman-Hollings, which was restored at the request of the President in fiscal 1987.

II. Authorization Request for 1988-90

A. Description

The Securities and Exchange Commission seeks a three-year statutory authorization for appropriations in the following amounts: $153.9 million for 1988, $169.0 million for 1989, and $181.1 million for 1990.

Since its creation in 1934, the Commission has played a major role in protecting the integrity and sound operation of the nation's securities markets for the benefit of investors. The Commission strives to fulfill this important responsibility in the most effective and efficient manner possible, so that investors receive the most benefit from the Commission's programs at the least cost to them, their companies and taxpayers. Facilitating capital formation and accommodating market changes require long-range planning, extensive study, and carefully measured implementation. A three-year authorization will strengthen the Commission's ability to plan and carry out its programs.

B. The President's 1988 Budget Request

The authorization request is based on the 1988 appropriation request of $145,036,000, which represents a 27% increase over the 1987 appropriation, as proposed to be amended. The appropriation request includes 2,267 staff positions, a 9% increase over 1987. The funding requested includes approximately:

- $43.8 million for enforcement operations (30%);
- $26.1 million for the full disclosure program (18%);
- $21.7 million for electronic filing (15%);
- $15.4 million for market regulation (11%);
- $13.3 million for investment management regulation (9%); and
- $24.7 million for legal, economic, and support services (17%).

The 181 additional personnel requested are for the following efforts:

- 73 for prevention and suppression of fraud (40%);
- 50 for full disclosure (28%);
- 17 for investment management regulation (9%);

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- 15 for program direction (8%);
- 12 for market regulation (7%);
- 9 for electronic filing (5%); and
- 5 for legal and economic services (3%).

Thus, the largest portion of the Commission's staff is allocated to its enforcement program. In fiscal 1987, the Commission authorized the hiring of 33 additional personnel for this program. In fiscal 1988, the Commission proposes to add 73 positions, 46 of which are slated for the regional offices. In 1987 and 1988 the Division of Enforcement in Washington plans to complete the staffing of a third associate director group. Regional office enforcement staffs will increase by 11%. The increased staff will be complemented by a 40% increase in microcomputer workstations and specialized software.

The President's budget requests $20 million in 1988 to cover startup costs of the operational electronic disclosure system known as "Edgar." The primary purpose of Edgar is to increase the efficiency and fairness of the markets for the benefit of investors, issuers and the economy by reducing from days and weeks to minutes and hours the public dissemination of time-sensitive corporate information. This will increase the utility of such information to investors, accelerate issuers' access to the market and increase their financing flexibility. Edgar will also assist the Corporation Finance and Investment Management Divisions in improving the efficiency, breadth and quality of their filing reviews and the Enforcement Division in its investigations.

The funds earmarked for Edgar's startup costs will enable the Commission to reimburse the contractor for actual expenditures incurred in connection with the acceptance and review system and for the portion of the receipt system required for the Commission's internal operations. The Commission's staff is currently reviewing the bids received for the operational Edgar contract. The terms and conditions of the contract will determine actual expenditures. Should the Commission not spend the full $20 million in 1988, it will not draw down any unused portion and will request that it be reappropriated later in the life of the eight-year contract. Over those eight years, 1987-1994, the Commission intends to reimburse the Edgar contractor $46.5 million. The 1988 authorization request includes an estimated 69 staff years

for Edgar management, contract administration and filer support and, based on partial time allocations, an estimated 58 staff year equivalents for the Divisions of Corporation Finance and Investment Management during the transition to Edgar.

C. Authorization Level for 1988

The funding levels in the 1988 authorization request generally address mandatory increases to the agency's current activity level plus workload generated by potential new legislation. There are a number of legislative proposals, including those concerning bank securities activities, tender offer regulation, and insider trading. Congressional consideration of these legislative proposals will require substantial Commission resources, and enactment would increase Commission responsibilities.

D. Authorization Level for 1989

In 1989, banking legislation which may be enacted in 1987 or 1988 would have a major impact if banks or their affiliates are permitted to enter broader segments of the regulated securities industry. All program areas would be affected by these increases in the regulated population. The government securities dealers newly regulated in 1987 would also create additional demands for resources in 1989.

The 1989 authorization level includes $15 million ($5 million less than 1988) for the Edgar operational system. This will be sufficient to accommodate the cost reimbursement contract, including the commitment that funds be available in any single year to cover the SEC's actual costs of system construction and operation. As in 1988, the total authorized level for Edgar may not be required to finance the Commission's portion of the system.

The continuing internationalization of securities markets, combined with continued growth and complexity in the domestic markets, is expected to require increases in inspections, enforcement actions, and rulemaking.

The 1989 pay raise is estimated at 3% for nine months in 1989. Inflationary economic assumptions account for 3.5% of nonpersonnel costs in 1989. Both the pay raise and inflation factors are based on Office of Management and Budget projections.

E. Authorization Level for 1990

In 1990, a continued increase in the regulated population would require added staff to review registrations and reports, provide legal and interpretive advice, conduct broker-dealer, SRO, investment company and adviser inspections and examinations, and institute enforcement actions. Similarly, transnational trading, enforcement, and information exchange are expected to increase, thereby affecting the regulation, enforcement and full disclosure programs.

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SEC staff resources devoted to Edgar in 1990 will continue at the 1989 level. The labor-intensive activity associated with the transition from the pilot, implementation of the operational system, providing training and support to first-time filers, and instituting the administrative and management system to oversee the project are planned to be completed in 1990. Thereafter, fewer staff will be needed to provide filer support and training.

The 1990 authorization request includes $10 million for the operational contractor, $5 million less than 1989. Just as the 1989 funding for Edgar needed to anticipate the actual costs of the system, 1990 is also structured to accommodate actual expenditures for SEC operations. In both 1989 and 1990 only those funds needed for actual expenses will be drawn against the authorized level.

As in 1989, OMB has provided pay raises and inflation factors. The pay raise is estimated at 3%. The inflationary economic assumption amounts to a 3.3% increase for non-personnel costs.

F. Multi-Year Justification

The budget process has required the Commission's senior staff to plan beyond the current year. The Commission has supported multi-year authorization legislation consistent with other Executive branch agencies as an effective method of managing program and administrative structures.

A three-year authorization will strengthen the Commission's ability to plan and carry out its programs, including, for example, the Edgar electronic disclosure system, the integration of office automation systems and the surveillance, enforcement and other demands of the growing domestic and international securities markets.

The operational Edgar system involves a commitment by the SEC and the Office of Management and Budget to support the project for eight years -- 1987 through 1994. The contractor must also commit personnel and financial resources for the entire period.

In addition, the Commission is making long-range plans for automated support for investigations and litigation. The Commission has long recognized the benefits of automation. Until now, it has emphasized mainframe systems services, augmented by microcomputers which provide specialized and localized computer capabilities. While this approach benefits the recipient organizations, it does not provide the substantial benefits to be derived from the introduction of automation to office management. As part of the

SEC's overall automation plan, the Commission plans an integrated office automation system. A limited pilot system beginning in 1988 will test various hardware and software configurations.

International agreements regarding trading, information linkages and cooperative enforcement require long-term commitments. A three-year authorization will demonstrate this nation's commitment to resolve these and other problems.

III. Insider Trading and Related Cases

A. The Commission's Enforcement Program

During fiscal 1986 and continuing in 1987, the Commission has devoted substantial enforcement resources to its insider trading program. "Insider trading" refers generally to the act of purchasing or selling securities, in breach of a fiduciary duty or other relationship of trust and confidence, while in possession of material nonpublic information about an issuer or the trading market for an issuer's securities. Provisions of the federal securities laws prohibit such trading not only by corporate officers and directors and other persons having a relationship of trust and confidence with the issuer or its shareholders, but also by persons who misappropriate material nonpublic information from sources other than the issuer. The tippees of any such persons may also be subject to the prohibition.

Insider trading is difficult to detect and even more difficult to prosecute. Unlike an investigation of a crime such as bank robbery, where enforcement authorities generally know at the outset that an illegal act has been committed, insider trading investigations typically are commenced to examine suspicious trades or trading patterns that may indicate a violation of the law, but may also reflect legitimate trading. Despite difficulties in obtaining evidence, the Commission's ability to detect, prosecute and deter insider trading has improved over the past five years. There have been significant improvements in the electronic surveillance capabilities of the securities exchanges and the NASD.

The Commission has also improved its ability to obtain evidence from foreign countries, utilizing both mutual assistance treaties and less formal memoranda of understanding with foreign governments. Agreements have been implemented with Swiss, Canadian, Japanese and United Kingdom authorities. In addition, broader treaties have been signed with the Cayman Islands and Canada in the last year. While the Commission has consistently assisted foreign governments investigating violations of their own laws, it is important to note that the Commission cannot assist foreign governments by exercising its authority to compel the production of evidence unless there has been a parallel

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violation of the U.S. securities laws. The Division of Enforcement is currently considering proposing legislative amendments to address this situation.

Since 1981, the Commission has brought 129 insider trading cases, as compared to 77 during the prior 47 years. During fiscal 1986, the Commission brought 30 insider trading cases, as compared to 20 cases in 1985. 1/ Moreover, the cases instituted in fiscal 1986 and thus far in fiscal 1987 include many of the largest and most significant cases in the Commission's history. A brief summary of some of the Commission's recent insider trading cases follows. 2/

1. SEC v. Dennis Levine, et al., 86 Civ. 3726 (RO) (S.D.N.Y. 1986)

On May 12, 1986, the Commission brought one of its most important insider trading cases against Dennis Levine, a New York investment banker. The Commission alleged, among other things, that Levine made $12.6 million over a six-year period by insider trading in the securities of at least 54 issuers using information learned through his employment about actual or proposed tender offers, leveraged buyouts, mergers, and other business combinations. Levine consented to a permanent injunction against future securities law violations and agreed to disgorge $11.6 million in illicit trading profits. He also agreed to an administrative order barring him from the securities business and to cooperate with the Commission in its investigation. At the same time, he pleaded guilty to one count of securities fraud, two counts of tax evasion, and one count of perjury. Levine is presently serving a two-year sentence in a federal penitentiary.

The Commission's continuing investigation of Levine's activities led to cases against other investment bankers and a lawyer, who allegedly misappropriated information from their firms, passed it

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1/ For statistical reporting purposes, the Commission classifies each enforcement action under one program area. During fiscal 1986, in addition to the 30 insider trading cases referred to in the text, there were four cases classified in other program areas that also involved allegations of insider trading.

2/ For a more complete discussion of these cases, see Statement of Gary Lynch, Director, SEC Division of Enforcement, Before the Senate Committee on Banking, Housing, and Urban Affairs (Apr. 22, 1987).

to Levine, and traded on information he provided to them. 3/ These individuals have agreed to pay $3.7 million in disgorgement and $875,000 in civil penalties. Each has also pleaded guilty to securities fraud or tax evasion charges.

2. SEC v. Ivan F. Boesky, 86 Civ. 8767 (S.D.N.Y. 1986)

The Levine investigation also led to the largest insider trading case in history, instituted on November 14, 1986, against the arbitrageur Ivan F. Boesky. In settling that action, Boesky consented to a permanent injunction and agreed to pay the equivalent of $100 million in cash and assets. Boesky disgorged $50 million of illegal profits in cash and surrendered securities valued at $50 million as a civil penalty. Boesky also consented to an administrative order barring him from the securities business and agreed to cooperate fully in the Commission's continuing investigation.

The Commission alleged that Boesky received information from Levine and had agreed to pay him for it. However, the Commission filed its complaint against Levine before he received any money from Boesky.

On April 23, 1987, Boesky also pleaded guilty to a felony charge of conspiring to file a false Schedule 13D with the SEC. He is awaiting sentencing.

3. SEC v. Martin A. Siegel, 87 Civ. 0963 (S.D.N.Y. 1987)

On February 13, 1987, the Commission sued Martin A. Siegel, another New York investment banker. The Commission alleged that Siegel passed confidential information acquired through his employment to Boesky and that Boesky traded on it. According to the complaint, Boesky had also agreed to compensate Siegel, and in fact made substantial secret cash payments to Siegel. Siegel entered into a consent decree in which he agreed to disgorge his entire ownership interest in the securities of the investment firm at which he was employed, his interest in partnerships sponsored by that firm, and cash and cash equivalents in the amount of approximately $4.25 million. Siegel further consented to a permanent injunction against future violations of the antifraud provisions of the securities laws and to an administrative order barring him from association with a broker or dealer. Siegel agreed to cooperate fully in the Commission's continuing investigation. He also agreed to plead guilty to criminal charges.

3/ SEC v. Robert M. Wilkis, et al., 86 Civ. 5182 (S.D.N.Y. 1986); SEC v. Ira B. Sokolow, 86 Civ. 5183 (S.D.N.Y. 1986); SEC v. David S. Brown, 86 Civ. 7774 (S.D.N.Y. 1986); SEC v. Ilan K. Reich, 86 Civ. 7775 (S.D.N.Y. 1986); SEC v. Randall Cecola, No. 86-9735 (S.D.N.Y. 1986).

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4. SEC v. Boyd L. Jefferies, et al.
87 Civ. 1804 (S.D.N.Y. 1987)

On March 19, 1987, the Commission brought an action against Boyd L. Jefferies ("Jefferies"), Jefferies & Co., Inc. ("Jefferies & Co.), a broker-dealer, and Jefferies Group, Inc., its parent company. Although this was not an insider trading case, it arose out of the Commission's Boesky investigation. The Commission alleged that the defendants violated the federal securities laws by market manipulation and by "parking" securities. As to the former, the complaint alleged that Jefferies entered into an arrangement with another person for whom he agreed to effect a series of transactions to support the price of a specific security so that trading in it would close at a certain price. The other person agreed to protect Jefferies & Co. from any losses it might incur from subsequently selling the securities.

With regard to the "parking" of securities, the Commission alleged that Jefferies agreed to make sham purchases of securities from Seemala Corp. ("Seemala"), a registered broker-dealer controlled by Ivan Boesky. Jefferies agreed with Boesky that Jefferies & Co. would hold the securities for Seemala and that Seemala would "buy" back the same securities shortly thereafter, take any profit or loss on the transactions, and compensate Jefferies & Co. for its cost of carrying the securities. The complaint alleged that the defendants thereby aided and abetted Seemala's violations of the Commission's net capital regulations, as well as violating or aiding and abetting violations of (1) beneficial ownership reporting requirements under Section 13(d) of the Exchange Act by failing to disclose membership in a group with Boesky; (2) books-and-records and filing requirements for brokers and dealers and public companies, by concealing information concerning the securities transactions and related agreements; and (3) margin requirements by, in effect, extending and receiving unlawful credit on the securities.

Each defendant consented to an injunction against future violations. Jefferies also consented to an administrative order barring him from the securities industry for at least five years. He also pleaded guilty to a felony charge.

5. SEC v. The First Boston Corp.,
86 Civ. 3524 (PNL) (S.D.N.Y. 1986)

In its case against the First Boston Corporation, brought in May 1986, the Commission alleged that the securities firm had engaged in unlawful trading for its own account, while in possession of material nonpublic information received from an investment banking client. First Boston allegedly received confidential information from a corporation concerning a forthcoming announcement

of a $1.2 billion addition to the corporation's property-casualty loss reserves. First Boston then placed the corporation on its restricted list, thereby restricting the firm from trading in the corporation's securities. In addition, First Boston's "Chinese wall" procedures prohibited the communication of this information to its trading department. Nonetheless, a First Boston insurance analyst told persons in the firm's trading department, who then disregarded the restricted listing, sold the corporation's stock, and purchased put options.

Without admitting or denying the Commission's allegations, First Boston consented to a permanent injunction against future violations, agreed to disgorge alleged illegal profits of $132,138, to pay a $264,276 penalty under the Insider Trading Sanctions Act, and to review and report back to the Commission on improving its "restricted list" and "Chinese wall" procedures.

6. Other Cases

The Commission has brought numerous additional insider trading cases in the past year. For example, several large cases, unrelated to the actions discussed above, have been brought alleging insider trading stemming from information improperly obtained by employees of investment banking or law firms. 4/

Many Commission investigations, in addition to those discussed above, have also led to criminal prosecutions of inside traders. One significant recent example concerned an insider trading group involving Michael David, a former associate of a New York law firm. 5/ All five defendants in that case have pleaded guilty to criminal charges.

B. Liability of Securities Firms for Insider Trading by Employees

Existing law provides that a firm may be liable for its employee's misconduct in certain circumstances. The issue turns on the particular facts of the situation, including whether the firm had adequate procedures designed to prevent and detect misconduct, whether it enforced such procedures, and whether the improper trading was done for the firm's or the individual's account.

4/ See, e.g., SEC v. Harvey Katz, et al., 86 Civ. 6088 (S.D.N.Y. 1986) (Commission obtained $2.1 million in disgorgement and $2.2 million in civil penalties); SEC v. Israel G. Grossman, et al., 87 Civ. 1031 (S.D.N.Y. 1987) (a pending case in which the Commission is alleging insider trading profits of approximately $1.5 million).

5/ See U.S. v. Andrew Solomon, 86 Cr. 451 (GLG) (S.D.N.Y. 1986); U.S. v. Daniel J. Silverman, 86 Cr. 452 (GLG) (S.D.N.Y. 1986); U.S. v. Robert Salsbury, 86 Cr. 453 (GLG) (S.D.N.Y. 1986); U.S. v. Michael David, 86 Cr. 454 (JFK) (S.D.N.Y. 1986); U.S. v. Morton Shapiro, 86 Cr. 455 (GLG) (S.D.N.Y. 19[illegible]

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Under Section 15(b)(4)(E) of the Exchange Act, the Commission may sanction a broker-dealer for the acts of its employees, if the firm has "failed reasonably to supervise" employees who commit violations. The Section provides that the firm will not be liable for a failure to supervise if it can establish that: (1) it had in place procedures that can reasonably be expected to prevent and detect violations and a system for applying the procedures and (2) the firm has reasonably fulfilled its obligations under these procedures, without reason to believe that the procedures were not being complied with.

In addition, a firm may have direct liability under Section 10(b) and Rule 10b-5 if an employee trades for the firm's account while in possession of material nonpublic information. In such cases, the trading is the firm's, and the employee's knowledge may be imputed to the firm.

The Commission has stressed the importance of establishing and following procedures to prevent misuse of information within a securities firm. While the Commission has not suggested that an impregnable "Chinese wall" is necessary, 6/ it has encouraged the use of procedures designed to prevent the misuse of material nonpublic information. 7/

6/ The Commission recognizes that investors and corporations benefit from the combination of expertise and facilities provided by multi-service firms. See In re Merrill Lynch, Pierce, Fenner & Smith, Inc., 43 SEC Docket 933 (1968). The Commission accepted an offer of settlement in which Merrill Lynch agreed to establish a Chinese wall policy prohibiting anyone in the underwriting division from disclosing material nonpublic information obtained in investment banking to others within the firm, except, where necessary, to perform the investment banking activity.

7/ For example, Rule 14e-3, which prohibits certain securities trading while in possesion of material nonpublic information concerning a tender offer, provides that an institutional trader does not violate the rule if: (1) the person who made the investment decision for the institution did not know the material nonpublic information; and (2) the institution had implemented reasonable policies and procedures to ensure that individuals who make investment decisions for the institution do not learn material nonpublic information or trade while in possession of such information.

Finally, broker-dealer firms also may be subject to private actions for damages resulting from insider trading. Recently, there have been a number of multimillion dollar damages actions brought against securities firms and others by bidders alleging that insider trading increased the price paid to acquire corporations. 8/

IV. Tender Offers

A. Overview

The Williams Act Amendments to the Securities Exchange Act of 1934 comprise the principal federal regulation of tender offers and disclosure of substantial acquisitions of publicly-traded equity securities. 9/ The Commission's ability to address abuses under the Williams Act and the proper scope of federal regulation generally have been the subjects of continuing Commission review. Where the Commission has determined that reform or clarification of certain aspects of the law is desirable, it has made legislative recommendations, undertaken rulemaking, participated as amicus curiae in private cases presenting novel or important issues, or, where it believed the law has been violated, has filed enforcement actions.

8/ See, e.g., Anheuser-Busch v. Thayer, et al., 86 Civ. CA3-85-0794-R (N.D. Tex. Aug. 19, 1986) (denying motion to dismiss action by bidding company alleging that defendants' trading on misappropriated nonpublic information concerning the proposed transactions caused price rise in the target company's stock); Litton Industries, Inc. v. Lehman Brothers Kuhn Loeb Inc., et al., 86 Civ. 6447 (S.D.N.Y. 1986) (investment banking firm sued by client for securities fraud, negligence, breach of contract, and breach of fiduciary duty in connection with unlawful trading by Dennis Levine and others). But cf. FMC Corp. v. Boesky, No. 86-C-9879 (E.D. Ill. dismissed Apr. 16, 1987) (district court concluded that FMC lacked standing to allege that it paid too much to its own shareholders in recapitalization as a result of Boesky's insider trading).

9/ The Williams Act, enacted in 1968 and amended in 1970, added Sections 13(d), 13(e), 14(d), 14(e), and 14(f) to the Securities Exchange Act. Act of July 29, 1968, Pub. L. No. 90-439, 82 Stat. 454; Act of Dec. 22, 1970, Pub. L. No. 91-567, 84 Stat. 1497 (codified at 15 U.S.C. 78m(d)-(e) and 78n(d)-(f) (1970)).

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On July 31, 1986, the Commission issued a concept release soliciting public comment on three specific issues related to takeovers and contests for corporate control. 10/ The concept release sought comment on whether the Williams Act should apply whenever a person acquires a substantial percentage of a target company's securities during or shortly after the expiration or voluntary termination of a tender offer, 11/ whether there should be a governmental response to the proliferation of "poison pill" plans, and whether the Commission should adopt a self-governance exemption to certain provisions of its tender offer rules. The comment period ended on December 1, 1986. The Commission staff has been reviewing the comments received to evaluate whether a regulatory response to these issues is necessary or desirable. The Commission recently published a summary of comments.

B. Current Legislative Proposals

There are currently a number of proposals to amend the Williams Act provisions of the Securities Exchange Act of 1934. Several of the most significant issues raised by those proposals are discussed below. 12/

10/ *See* Securities Exchange Act Release No. 23486 (July 31, 1986).

11/ The inquiry was a response in part to recent court decisions holding that purchases of a target company's shares during or shortly after a tender offer fall outside the scope of the Williams Act. *See* *SEC v. Carter Hawley Hale Stores, Inc.*, 760 F.2d 945 (9th Cir. 1985) (the Commission sued Carter Hawley alleging that the issuer purchase program constituted an unconventional tender offer that should have complied with the Williams Act and the regulations thereunder; the Ninth Circuit rejected the Commission's position); *Hanson Trust PLC v. SCM Corp.*, 774 F.2d 47 (2d Cir. 1985) (the Commission filed an amicus brief arguing that Hanson's bid termination and immediate private purchases raised sufficiently substantial questions under the Williams Act to justify a preliminary injunction; the Second Circuit did not agree).

12/ On April 2, 1987, Commissioner Charles C. Cox testified on behalf of the Commission before the Subcommittee on Antitrust, Monopolies and Business Rights of the Senate Judiciary Committee concerning federal regulation of tender offers. His testimony centered on the most recent proposals for reform of existing federal regulation of tender offers. Although the Commission has not yet considered the specific proposals before the Senate in the 100th Congress, it has studied many of the issues and taken positions on prior, similar proposals, or addressed these issues in other contexts. His testimony set forth the arguments for and against various proposals presently under consideration. Accordingly, this testimony will not discuss these issues in detail.

1. Section 13(d)

The purpose of Section 13(d) of the Securities Exchange Act of 1934 is to provide adequate disclosure to investors of acquisitions that might lead to a change in control of the company. Section 13(d)(1) requires persons who acquire beneficial ownership of more than five percent of a class of equity securities in a company to notify the issuer, each exchange on which the security is traded, and the Commission of certain specified information. The acquiring shareholder has ten days after crossing the 5% threshhold within which to submit the required information, allowing the shareholder to acquire additional shares within that period prior to making any disclosure. In some situations, the ten-day filing period has enabled persons to acquire substantial positions prior to disclosure. The Commission has proposed legislation to reduce the ten-day filing period to two days.

2. Greenmail

"Greenmail" refers to an issuer's selective repurchase of a block of shares from a shareholder or group of shareholders, generally at a premium over the market price of the stock. "Greenmail" may be used by target company management to eliminate a threatened hostile takeover attempt or to remove dissident shareholders.

In 1984, the Commission proposed legislation that would have prohibited issuers from repurchasing their securities at a premium above their market price from persons who had held more than 3% of the class of securities for less than two years unless the issuer made a similar offer to all holders of the class of securities, or had prior shareholder approval. In January 1986 the Commission concluded that direct economic consequences to the paying corporation, market forces, state actions, shareholder litigation, changes in the tax laws and the adoption by many companies of by-laws that prohibit the payment of "greenmail," had significantly inhibited the payment of "greenmail."

The recent resurgence of this activity includes Goodyear Corporation's repurchase of shares from Sir James Goldsmith, CPC International's repurchase of shares from Ronald Perelman, and repurchases by USG Corporation, Ashland Oil and Potlatch Corp. of shares from the Belzberg family. As a consequence, the Commission is again reviewing "greenmail" with a view to the possibility of regulatory or legislative proposals.

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3. Unconventional Tender Offers

Recent court decisions narrowly construing what constitutes an "unconventional tender offer" that must be made in compliance with the Williams Act 13/ have prompted the Commission to study issues raised by substantial share acquisitions outside of the tender offer process. In its July 31, 1986 concept release, the Commission sought comment on whether regulatory action was necessary to ensure that substantial purchases during the course of or immediately following the termination of a tender offer were made in compliance with the Williams Act. Such a requirement would prevent buyers from using the market forces created by a pre-existing tender offer to acquire control of a company. It would also respond to concerns that the present regulatory scheme may encourage bidders to put a company "in play" by making a tender offer, only to bypass the Williams Act by terminating the offer and buying from market professionals, and that issuers and their "white knights" can defeat tender offers by buying from market professionals during the tender offer while the original offeror is prohibited from making such purchases.

4. "Poison Pills" and Other Defensive Tactics

The Commission also is reviewing issues raised by extraordinary restructurings undertaken by target corporations to defeat or deter tender offers. These include the acquisition or disposition of significant corporate assets, and the issuance or redemption of securities with extraordinary rights, commonly referred to as "poison pills."

C. CTS Corp. Decision

The Supreme Court's recent decision in CTS Corp. v. Dynamics Corporation 14/ could inhibit hostile tender offers. In this case, the Supreme Court upheld the validity of the Indiana Control Share Acquisition statute. The Indiana statute provides that whenever any person acquires more than 20%, 33% or 50% of the outstanding shares of certain Indiana corporations, those shares lose all voting rights. Those voting rights may be restored by a majority vote of "disinterested" shareholders, including those who may have tendered into the offer. The Court held that the statute was neither pre-empted by the Williams Act nor an impermissible state regulation of interstate commerce. In a related matter, the Supreme Court vacated a lower court judgment

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13/ See supra, note 11.

14/ Nos. 86-71 and 86-97 (U.S. Apr. 21, 1987).

in Ohio v. Fleet Aerospace Corp. 15/ and remanded the case to the U.S. Court of Appeals for the Sixth Circuit for further consideration in light of CTS.

Similar statutes are likely to be enacted by other states. The Commission staff is evaluating the probable effects of such laws on its regulation of tender offers and considering whether changes in federal regulation will be needed.

V. Dual-Class Capitalization

The New York Stock Exchange ("NYSE") and the Pacific Stock Exchange ("PSE") have submitted proposed changes to their rules to permit the initial or continued listing of the securities of issuers having multiple classes of common stock with unequal voting rights. At present, the rules of the NYSE and the PSE prohibit the listing of any securities of a company that has issued common stock with disparate voting rights. The rules of the American Stock Exchange prohibit listing of non-voting stock and limit disparities in voting stock. By contrast, the National Association of Securities Dealers ("NASD") has no listing standards with respect to the voting rights of stock issued by companies admitted for quotation on its automated quotation system ("NASDAQ").

Public hearings were held on December 16 and 17, 1986 concerning the NYSE's proposal to permit listed companies to issue classes of common stock with different voting rights upon approval by a majority of their independent directors and public shareholders. The Market Regulation Division is analyzing the comments and alternatives.

In a March 13, 1987 letter to the Commission, the NASD has proposed the adoption of a uniform rule by each equity securities market that would prohibit the listing of securities with unequal voting rights. This uniform rule would be subject to limited exceptions for companies that have dual-class capital structures at the time of their initial public offerings or that otherwise take action that does not disproportionately reduce the voting rights of existing shareholders.

While the NASD has not filed an amendment to its rules for Commission consideration, the NASD, the NYSE, and the Amex are discussing the possibility of proposing a uniform rule with respect to shareholder voting rights in light of the NASD's suggestion.

15/ No. 85-344 (U.S. Apr. 27, 1987).

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VI. Program Trading

By telescoping into minutes and hours transactions previously executed over days and weeks, computerized hedging and arbitrage have increased market volatility in dollars, but not in percentage changes of the averages. Stock index options and futures enable investors, underwriters and others to hedge market risks at a fraction of the prior costs. Computerized arbitrage brings the prices of options and futures into line with those of the underlying securities, which increases the efficiency and liquidity of the markets.

To dampen the volatility on quarterly settlement dates when options and futures expire, the Commission proposed that certain order imbalances be displayed on the ticker tape during the last half hour of trading. The results have been encouraging. The Commission also encouraged and endorsed the Chicago Mercantile Exchange's ("CME"), the NYSE's, and the Chicago Board Option Exchange's proposals to settle certain stock index futures and options at opening instead of closing prices, and the CME's proposal to increase its margin requirements. The Market Regulation Division is monitoring these efforts and considering others to dampen interim and settlement volatility.

On September 11 and 12, 1986, the Dow Jones Industrial Average dropped 120 points on record volume, one of the sharpest market declines in history. 16/ The Market Regulation Division, with the assistance of the staff of the Commodity Futures Trading Commission, has reviewed this index-related trading to determine whether the market decline lent credence to concerns over the effects of index-related trading. The staff examined the magnitude of index-related trading in relation to overall market activity, the types of trading strategies that were involved, and the impact of this activity on market prices and volume, as well as fundamental economic factors. The staff concluded that the magnitude of the September decline resulted from changes in investors' perceptions of fundamental economic conditions, rather than from artificial forces arising from index-related trading strategies. Nevertheless, index-related futures trading facilitated the rapid transmission of these changed investor perceptions to individual stock prices and may have condensed the time period in which the decline occurred.

16/ The Dow's 86 point drop on September 11 was the largest single-day price move in terms of absolute points on the Dow average, and the largest on a percentage basis (4.61) since 1962.

VII. Internationalization

The benefits of the increasing internationalization of securities markets are enormous. The challenges are also great and immediate.

Foreign securities have become important vehicles for U.S. investors, and raising capital abroad has become significant to U.S. companies. For example, U.S. issuers raised a record $43.7 billion through international bond issues in 1986. Foreign issuers borrowed $6.1 billion in the U.S. bond market during the same year. On the equity side, U.S. investors purchased and sold $101.2 billion in foreign stock in 1986 while foreign investors' activity in U.S. corporate equity securities reached $277.3 billion.

This accelerating internationalization of the securities markets is significantly changing the ways in which the securities markets function and presents opportunities as well as challenges to market participants and to regulators. The Commission has increased its efforts to facilitate the development of international markets in a manner consistent with the U.S. securities laws.

Currently, the Commission is completing a report on the internationalization of the securities markets requested by the House Committee on Energy and Commerce and the Senate Committee on Banking, Housing and Urban Affairs. The report will cover a wide range of topics, including the scope of internationalization, multinational registration and disclosure issues, the functioning and regulation of international secondary markets and market professionals, the participation of investment companies in international markets, and the enforcement of the U.S. securities laws in an era of internationalization. The Commission submitted its interim progress report in October 1986 and expects to submit the final study in June.

As part of the study, the Commission sponsored a Roundtable on February 17, 1987. The participants, who included experts on many different aspects of internationalization, generally believed that the Commission should not impose additional regulations but rather should facilitate appropriate market development, that international clearance and settlement remain a significant problem, and that development of mechanisms for information sharing and surveillance among regulators is needed. Roundtable participants also suggested liberalization of registration restrictions in the Securities Act of 1933 to allow sophisticated U.S.

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investors to participate directly in unregistered foreign offerings. 18/

Over the last few years the Commission has taken action in these and other areas. For example, the Commission has approved the establishment of linkages between U.S. and foreign markets, including trading linkages between the Boston Stock Exchange and the Montreal Exchange; between the American and Toronto Stock Exchanges; and between the Toronto and the Midwest Stock Exchanges. The Commission has also temporarily approved a quotation-sharing program between the NASD and the International Stock Exchange (formerly the London Stock Exchange). To ameliorate the problems surrounding international clearance and settlement, the Commission's staff has issued no-action letters to foreign clearing agencies wishing to establish automated securities processing links with their U.S. counterparts. The Commission also is considering the facilitation of multinational securities offerings through adopting reciprocal prospectus requirements with certain other countries. 19/

The Commission has emphasized the need to enforce the federal securities laws in the context of increasingly international markets. To accomplish this, the Commission has required that linked foreign and domestic markets, acting as self-regulatory organizations, develop surveillance and information sharing agreements. In addition, the Commission has pursued bilateral and multilateral mechanisms for obtaining information to carry out its enforcement responsibilities. In particular, as noted above, the Commission has taken the initative in negotiating international agreements providing for cooperation and information sharing with Swiss, Japanese, Canadian and U.K. authorities. Others are contemplated.

18/ On the day following the Roundtable, the Division of Corporation Finance issued a no-action letter to College Retirement Equities Fund clarifying Securities Act Release No. 4708 (July 9, 1964) to make it clear that a U.S. fund could buy unregistered French securities issued in the "privatization" of formerly state-controlled French enterprises. In April 1987, the Division issued a no-action letter to the French government with respect to procedures used to accomplish French privatizations again stating its view that U.S. private offerings of the securities could be accomplished concurrently.

19/ See Securities Exchange Act Release No. 21958 (April 18, 1985), 50 Fed. Reg. 16302.

VIII. Bank Securities Activities

On July 23, 1986, the Commission testified before the Subcommittee on Commerce, Consumer, and Monetary Affairs of the House Committee on Government Operations in support of the Treasury Department's recommendations to permit banks to underwrite municipal revenue bonds and mutual funds. The Commission also stated that banks should be required to conduct both new and existing securities activities (such as underwriting government and general obligation municipal securities) in separate corporate affiliates within holding company structures and that these separate corporate affiliates should be subject to SEC regulation.

On May 1, 1987, the Commission submitted to Congress a legislative proposal to subject bank brokerage activities to SEC regulation.

The Commission has also endorsed the legislative recommendations of the Bush Task Group to

- Subject public offerings of securities (but not deposit instruments) by banks and thrifts to the registration requirements of the Securities Act; and

- Transfer administration and enforcement of disclosure requirements under the Securities Exchange Act for such securities exclusively to the Commission.

Under the current system, the bank and thrift regulatory agencies have jurisdiction over disclosure requirements for securities issued to public investors by about 400 banks and 300 thrifts, while the Commission has jurisdiction over such requirements for securities issued by about 1,000 bank and thrift holding companies. This means that there may be differences in disclosures relating to banks depending on whether they are owned by holding companies. Each of the depository regulators has staff performing the functions handled by the Commision for the 11,000 other publicly-owned reporting companies.

The proposed legislation would consolidate within the Commission the financial disclosure requirements for all publicly-owned companies, as well as for all public offerings of securities. If adopted, it would ensure that investors will receive the same disclosure protections with respect to securities issued by publicly-owned banks and thrifts as they now receive for other publicly-owned companies.

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IX. Accounting and Auditing

The Commission has proposed for comment a rule that would require periodic peer review for accountants that certify financial statements filed with the Commission. Peer review is, in effect, an "auditor's audit" -- a regular, independent examination of accountants' quality control systems by other accountants engaged in public practice to assess whether audits are being conducted in accordance with generally accepted auditing standards.

The auditors of a large majority of public companies currently participate in the peer review program of the SEC Practice Section ("SECPS") of the American Institute of Certified Public Accountants ("AICPA") Division for CPA Firms. Recently, several organizations and individuals have suggested that membership in the SECPS or a similar organization requiring peer review should be mandatory for accountants whose reports are filed with the Commission. Those advocating mandatory peer review include the National Commission on Fraudulent Financial Reporting, the AICPA Council, and representatives of eight major accounting firms.

In view of these developments and the Commission's continued support of peer review as a means of providing added assurance that auditors are consistently complying with professional standards, the Commission recently proposed rules that would require accountants reporting on financial statements included in filings with the Commission to undergo a peer review at least once every three years. 20/ An accountant could obtain its peer review under the auspices of a private sector peer review organization meeting specified standards or, alternatively, could have its peer review conducted by the peer reviewer of its choice, with the review supervised directly by the Commission. The Commission's proposing release also requests comment on means other than mandatory peer review, including a disclosure requirement, by which the Commission could encourage the use of peer review to improve the quality of audits and adequately inform investors of whether accountants have been peer reviewed.

X. Investment Management Developments

The Investment Management regulation program minimizes the risk to investors of loss from fraud, self-dealing, misleading disclosure, and other abuses in the investment company and investment adviser segments of the financial services industry.

20/ Securities Act Release No. 6695 (April 3, 1987).

A. Mutual Fund Regulation

The Commission has proposed to standardize the computation of mutual fund performance data used in advertisements and sales literature. The proposals are intended to permit meaningful comparisons of fund performance claims and to help investors better understand those claims. The Division of Investment Management is conducting a review of Rule 12b-1, a rule adopted in 1980 that permits mutual funds to use their assets to pay distribution expenses. The review focuses on development of Rule 12b-1 plans and distribution practices and the need for additional disclosure from registrants that have such plans.

B. Investment Advisers

In the past several years, the number of investment advisers has grown significantly (4,200 registered advisers in 1981 compared to 11,000 as of December 1986). In light of this increase, the Division of Investment Management has increased the productivity of the adviser inspection program and is also evaluating existing regulation and considering possible regulatory alternatives. One approach is a self-regulatory organization for investment advisers. A "full scale" SRO could assume responsibility for establishing and administering proficiency standards, conducting routine inspections, and disciplining members. Alternatively, an SRO performing inspections only could keep the Commission abreast of industry growth without creating an additional regulatory structure, although Commission oversight would still be required. Upon the recommendation of the Investment Management Division, the Commission endorsed the NASD's proposed pilot inspection program for the investment advisers of its members and their affiliates, which account for 43% of registered investment advisers.

At Congress's request, the Commission is conducting a study of the financial planning industry to assess whether regulatory changes should be made. The study will analyze planner characteristics and compensation, customer demographics, registration and inspections, and instances of fraud and abuse. The primary focus of the study is on 100 special financial planner inspections conducted by the Commission with the participation of state securities regulators. The staff will also evaluate the NASD pilot program. The study should be completed by the end of 1987.

C. The Public Utility Holding Company Act

The Commission has proposed repeal of the Public Utility Holding Company Act of 1935, the principal purpose of which (the dismantlement of the multitiered public utility holding companies) was achieved over 20 years ago.

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XI. Financial Guarantee Study

As part of the Government Securities Act of 1986, Congress directed the Commission to report on the use of the exemption in Section 3(a)(2) of the Securities Act for securities guaranteed by banks and the use of insurance policies to guarantee debt securities. The Commission issued a concept release 21/ and received numerous comments from insurance regulators, insurers, banks, rating agencies, and others. In addition, it held a public hearing on March 23, 1987 to hear testimony on the issues raised. Currently, the Commission's staff is preparing a report to Congress and is consulting with the federal banking agencies.

XII. Technical Amendments

In 1983, the Commission proposed the Securities Law Technical Amendments Act to make technical, clarifying, and conforming amendments to the securities laws. In 1985 the Commission submitted a revised version of the bill to Congress.

The Commission continues to endorse the enactment of the technical amendments and believes that the proposals are non-controversial. The great majority eliminate typographical errors and obsolete and ineffective provisions.

* * *

Thank you for this opportunity to present this overview of the Commission's fiscal 1986 results, its 1988 - 1990 authorization request, and its ongoing efforts.

21/ Securities Act Release No. 6688 (Feb. 6, 1987).