Remarks Of

Richard Y. Roberts
Commissioner*
U.S. Securities and Exchange Commission
Washington, D.C.

"Securities Litigation Reform and Multiplicity of Securities Regulatory Schemes"

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*/ The views expressed herein are those of Commissioner Roberts and do not necessarily represent those of the Commission, other Commissioners, or the staff of the Commission.

U.S. Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

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I. Introduction

I appreciate the opportunity to address this prestigious body. It is an interesting time for Washington observers. Certainly the winds of "change" have swept through the White House, the U.S. House of Representatives, and, to a lesser extent, the U.S. Senate. Sometime next year, this "change," carried by new policy leaders, will wind its way through the federal bureaucracy, including the Securities and Exchange Commission (the "Commission"). No one knows what the future will bring; but I do long for a Commission that is less micro-managed, and is operated in a more open, collegial fashion. In sum, I hope that "change" will result in a kinder, gentler Commission. For that result to be achieved, changes in Commission membership and changes in Commission personnel will be required.

It has consistently been brought to my attention that the number one objective for the Commission in the near future will be to provide the appropriate regulatory framework that will enable the United States to be the focus internationally for securities transactions. The Commission's disclosure requirements, in particular the accounting ones, are usually identified as the largest obstacle to the achievement of that objective. I disagree, but only to the extent that I believe that there are two larger problems --- the litigation that is so commonplace in our country and the multiplicity of regulatory schemes that exists in our country.

Thus, it is my intention today to share some of my thoughts with you on the subject of securities litigation reform and on the problem posed by the multiplicity of securities regulatory schemes.

II. Litigation Reform

I do believe that some reform of our securities litigation system is warranted. There exists support in the Commission for reforms such as the loser pays all litigation costs, a comparable negligence standard, and limitations on the scope of civil Racketeer Influenced and Corrupt Organizations Act ("RICO") actions. As I understand it, the support in the Commission for the English rule, or a rule where the loser pays all litigation costs, is predicated on the condition that the rule would not apply to Commission proceedings. I find that stand puzzling, since if the English rule is such a good rule, I would expect that those who support such a rule would be willing to accept such a rule. Otherwise the argument can be made that such support is somewhat duplicitous. I may not be a supporter of the English rule under any circumstances, but certainly not under those circumstances.

I am also probably not a supporter of a comparable negligence standard. Most Commission actions require more than negligence, even though they are civil in nature and use a preponderance of the evidence standard. Thus, a comparable negligence standard is rather meaningless so far as Commission litigation is concerned.

One may inquire what difference does it make if a particular reform has no impact on Commission litigation practices. Well, the answer is that, in my judgment, government initiated securities litigation spawns other litigation and is a substantial contributor to our securities litigation problem. A cursory review of recent Commission administrative proceedings leads easily to that conclusion. For example, if you have not already done so, you should take a look at the chronology of the Checkosky-Aldrich case or the more recent Donald Sheldon case. They are bewildering, interminable, and mind-boggling. Some of our other litigation practices are also subject to criticism in my view. For example, several of our bank enforcement cases were weak at best and, at worst, stretch the concept of materiality, in an accounting sense, to the point where there seems to exist no such thing as immateriality.

My object is not to criticize unduly Commission enforcement cases. By and large, I believe that the Commission's enforcement program has been conducted in an exemplary fashion. I merely wish to emphasize that when one is preaching reform, sometimes it is best to reform at home first before proceeding to reform the world. Hopefully, in the near future, among other things, the Commission will publish an administrative proceeding task force report and will begin to implement the reforms contained in that report.

Meritless securities litigation is a problem in my judgment. Government litigation reform can assist in the solution of the problem. If the Commission is bound and determined to pursue litigation reforms outside of Commission operations, then it is my judgment that the reform most worth pursuing is RICO reform.

While RICO, like the securities laws, provides for recovery by victims of fraud, the civil liability provisions of RICO operate in many cases to convert otherwise untenable routine private securities fraud claims to successful verdicts, by exposing defendants to extraordinary liability not available under the securities laws themselves. RICO entitles successful plaintiffs in those cases to treble damages, despite the express limitations under the federal securities laws to actual damages. By allowing private plaintiffs to bypass the carefully crafted liability provisions of the securities laws, RICO has thus tended to undermine the balanced structure that has developed under those federal securities laws. This distortion imposes substantial costs on our capital formation system and is an impediment to the globalization of our securities marketplaces.

At a minimum, RICO should be amended to limit civil actions to major and serious frauds and thereby to eliminate it as a mainstay of commercial litigation, without depriving victims of egregious conduct adequate judicial recourse. By addressing the abuse of RICO in private actions that are essentially securities fraud cases, a measure of appropriate reform could be accomplished in the area of securities litigation; and the efficiency and globalization of our capital formation process should be correspondingly moved forward.

By zeroing in on RICO reform, a meaningful step in the direction of securities litigation reform becomes viable. However, the area most deserving some reform is the Commission's own litigation operations.

III. Multiplicity of Regulation

I also believe that the multiplicity of regulatory schemes encountered by securities industry participants is a problem for the globalization of our securities marketplaces. While I support the concept of a single federal regulator as recently advocated by Jack Sandner of the Merc, I suspect that a congressional consensus for such a concept will not be forthcoming in the near future. In any event, the multiplicity of federal regulatory schemes is not all of the problem. The existence of dual state/federal securities regulatory schemes is also part of the problem, potentially the most significant aspect of that problem.

In a perfect world, it would be nice to have a non-overlapping state/federal securities regulatory scheme in place. However, the U.S. securities regulatory world is far from perfect and will not become perfect in the near future. The Commission has little control over most of these imperfections, but I believe it could do more.

While the Commission has made great strides to minimize the state/federal regulatory duplicity present in filing requirements for broker-dealers, investment advisers, and investment companies with the one-step filing concept, it did not take advantage of at least two other opportunities in this area that were present last year. The first such opportunity was the Commission's small business initiative, and the second was the investment adviser legislation considered in the last Congress.

With respect to the Commission's small business initiative, the Commission adopted rules this year to improve the efficiency of the small company capital formation system in a hasty, politically motivated manner. Yet, the rules adopted appear to be sound at least in substance. So, one may ask, what is the problem. The answer is that for a Commission initiative designed to reduce burdens on capital formation to have much impact, the Commission must be able either to preempt similar state rules or to persuade the states to tailor their rules accordingly.

Now the Commission has little in the way of state pre-emptive power. Further, by adopting the small business rules while moving at warp speed and while acting in, how shall I say it, a regal manner, the Commission neglected to make much of an effort to cooperate with state securities regulators and to achieve the state/federal acceptance the rules need in order to have a significant impact.

As Professor Sargent stated in his recent Business Law Today article entitled "No More Tinkering! Let's Scrap the SEC's Rube Goldberg Contraption for Small Business Offerings," "[n]o reform of federal securities regulation will work unless the state securities regulators have signed on, both in principle and in detail. The state regulator's sovereign ability to superimpose upon offerings in their jurisdictions additional, inconsistent or even prohibiting criteria means that they indeed have the last word, and that they can reduce the best-intentioned federal reforms to practical insignificance."

I do not know that with more of an effort, the Commission could have achieved the cooperation of state securities' regulators to implement a state/federal small company capital formation regulatory scheme. However, such an effort should at least have been expended. Thus, the Commission should begin immediately, after the winds of "change" have swept through our agency, to resurrect the notion of federal-state cooperation designed to improve the efficiency of the small business capital formation process. As matters presently stand, the Commission's small business initiative, while sound in substance, has not achieved much acceptance at the state regulatory level and therefore has minimal impact.

Concerning investment adviser legislation, during the last Congress, the Commission supported increasing investment adviser fees as a means to increase Commission resources in order to improve the Commission's inspection program for investment advisers. However, the facts are that:

- o More than half of all registered advisers have no assets under management, and more than half of those that do have assets under management manage less than $10 million.
- o Fewer than 200 registered advisers manage more than $5 billion in assets.
- o More than half of all registered advisers have fewer than 15 clients.
- o Only about 275 advisers have more than 500 clients.
- o More than half of all registered advisers have only one employee performing advisory functions.
- o Only about 5% of registered advisers have 10 or more employees performing advisory functions.

It seems pretty clear to me that advisers come in different sizes. There are relatively few large advisers but lots and lots of small advisers.

Although fewer than 5% of all advisers manage more than $500 million in assets, these advisers are responsible for more than 70% of the assets advisers have under management. These advisers have discretionary authority over substantial amounts of the money of other individuals, and how they exercise this authority has significance not only to their clients, but to our national securities markets and to our national economy.

In contrast, most small advisers have no control over client assets or control relatively small amounts of assets. Their activities are important to their clients and to their communities, but probably have little impact on the national economy. Even in the aggregate, the impact of small advisers on the national economy is much less significant than that of large advisers.

I suggest that some form of classification of advisers is needed if there is to be any fundamental and long-term improvement in investment adviser regulation. It appears to me that investment advisers should be classified on what is probably the simplest basis possible -- size. Small advisers should be subject solely to state regulation, and large advisers should be subject solely to federal regulation. While I realize that the support for this concept is just not there at the moment, the notion of a non-overlapping investment adviser regulatory scheme, divided between the states and the Commission on the basis of size, is a concept that I would be interested in pursuing in the future. Certainly, theoretically, it appears to me that such a concept is a more cost effective regulatory response to the growth of the investment advisory industry than was the investment adviser legislation considered in the last Congress.

The Commission's small business initiative and proposed investment adviser legislation represent two striking instances where the Commission had an opportunity, but failed, to minimize the dual state/federal securities regulatory schemes which are encountered by securities industry participants every day and which pose a substantial impediment to the globalization of our securities marketplaces. Possibly the Commission can resurrect and still capitalize on those two opportunities. At a minimum, we should be alert for more such opportunities.

V. Conclusion

There are a number of other matters that I have neglected to mention today that I hope will be the focus of some Commission attention during the next year. Specifically among those are the need to extend the amendments to Investment Company Act Rule 2a-7 adopted by the Commission last year to tax-exempt money market funds, the need to formalize the Commission's rating agency designation process, and the need to pursue legislative reform to require that interests in all pooled investment products, including bank collective trust funds and insurance company separate accounts, sold to pension plan participants register with the Commission so that full and fair disclosure to every pension plan participant responsible for investing his or her own retirement monies is provided. The Commission should also be attentive to the progress of voluntary transparency initiatives in the government securities market and to the progress of voluntary secondary market disclosure initiatives in the municipal securities market, as well as to the progress of the Municipal Securities Rulemaking Board's study of their customer protection rules. Further, the Commission should continue to be attentive to ideas on how to improve the efficiency of our capital formation system.

Of course, the Market 2000 Study needs to be completed, work on the recommendations flowing from that Study needs to begin, and work should continue on implementing some other recommendations contained in the Investment Company Act Study that I have not mentioned. Most importantly, as advocated recently by former Commissioner Phil Lochner, the Commission should continue to work toward putting into place an appropriate regulatory scheme to make the United States the focus of international securities trading in the next century. This requires a continuing effort to reach an international accounting accord and a willingness to explore new ideas such as the New York

Stock Exchange's concept to attract foreign listings to their marketplace.

In substantive terms, I have enjoyed my first two years on the Commission. I have found the Commission to be an intriguing place to work. Commission activity in the securities public policy realm has been both fascinating and challenging. I do look forward to my next two years on the Commission, which I hope will be as interesting as my first two, and even more enjoyable.