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Major SEC Efforts and Issues

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Ladies and Gentlemen:

It is a pleasure to be with you. Today, I would like to highlight some major SEC efforts and issues - and then solicit your comments and suggestions.

Prologue

In 1981, at the securities industry's annual convention, I said, "Since the end of World War II, the nation's monetary, fiscal and regulatory policies have become increasingly antithetical to capital formation.

- mounting regulatory burdens;
- rising inflation, corporate and individual taxes;
- inadequate depreciation allowances;
- double taxation of dividends;
- and one of the highest effective rates of capital gains taxation in the industrialized free world;
- have been emphatic disincentives to saving and investing."

That "As a consequence, America's relative rates of capital formation, productivity and growth have plummeted, from one of the highest to among the lowest of the industrialized nations."

That, "The Economic Recovery Act of 1981 is an excellent beginning, and I have great confidence in the President's overall program".

And I pledged

- "to help reduce excessive regulations;
- to help facilitate, instead of inhibit, capital formation, corporate financings and efficient markets;
- and to help maintain investors' confidence in our markets through more effective disclosure, oversight and antifraud enforcement."

Some of these hopes and objectives have come to pass. Among other things, the Economic Recovery Act of 1981 increased depreciation allowances by 14% and reduced the corporate, individual and capital gains tax rates by over 25%.

By 1983, the rate of inflation had been brought down 60%, the prime rate 50%, and our productivity and growth rates had more than doubled. All of which gave impetus to the broadest and strongest stock, bond and new issue markets in history.

Also since 1981, the SEC has increased investor protections and corporations' financing flexibility, and reduced unnecessary corporate paperwork and other expenses by over $2 billion per annum.

Integration and Shelf Registration

For example, the integration of corporations' registration and reporting requirements and the shelf registration rule, are saving corporations for the benefit of their shareholders, over $1.5 billion a year in paperwork, underwriting and interest costs - without compromising full disclosures to the investing public.

Whether or not a company has filed a shelf registration statement, it must of course continue to make full disclosures of its interim and annual results and other material developments.

Private Placements

Over $45 billion per annum of securities are being offered to institutional, accredited and other investors under new private placement and small business exemptions from SEC registration requirements, at savings of over $400 million per annum to companies and their shareholders.

Institutional Book-Entry

Expansion of the institutional, electronic book-entry delivery system, in lieu of the physical delivery of securities by institutions, is also saving over $400 million per annum of expenses ultimately borne by investors.

Proxy Simplification

Simplification and improvement of proxy statements and prospectuses have reduced their cost and increased their utility to investors.

SEC/CFTC Accord

Resolution of the 7-year turf battle between the SEC and the Commodity Futures Trading Commission has permitted authorization of trading in new options and futures, which enable investors, corporations and others to hedge stock market, foreign currency and other risks, at a fraction of the costs of prior means of hedging or reducing such risks and in multi-billion dollar amounts that were not previously possible. These new instruments have also increased the breadth and liquidity of the securities and other markets.

Insider Trading Sanctions Act

To inhibit insider trading the SEC proposed the Insider Trading Sanctions Act.

Most inside traders have only been compelled to disgorge their profits - which has not been much of a deterrent. Now they are subject to fines up to three times their profits, as well as criminal sanctions.

The Commission is also preliminarily considering the possibility of offering rewards to those who inform on inside traders and market manipulators. The IRS and the Departments of Justice and Defense offer such rewards.

Intermarket Surveillance

At the SEC's initiative, electronic intermarket stock and options surveillance systems and transaction audit trails, have been installed

- o to facilitate detection of market manipulators and inside traders;
- o improve last sale reporting;
- o and reduce transaction reconciliation costs, that are ultimately borne by investors.

Clearinghouse Deposits and Net Capital

Updating the securities industry's net capital and clearinghouse deposit requirements, has freed-up over a billion dollars of capital and helped investment bankers and brokers finance the record volume of trading and financings.

SEC Budget Surplus

While many independent agencies' budgets have been reduced, contrary to a common misconception, the SEC's budget has been increased - by over 40% since 1981.

In any case, in each of the last three fiscal years, registration, transfer and other fees have exceeded the Commission's $90 to $106 million budget, which has only happened once before in the past 51 years. The three-year surplus has amounted to over $70 million - and the 1986 surplus is expected to exceed $30 millon.

Annual Volume Increases

Also since 1981, through automation, paperwork reduction and other improvements, each SEC division has achieved record results, or the highest levels in years, with 2% to 5% less personnel.

The annual volume of

- o enforcement actions has been increased by over 40%;
- o corporate filings reviewed, by over 50%;
- o broker-dealer oversight examinations, by over 60%;
- o self-regulatory organization inspections, by over 70%;
- o and investment company and adviser inspections, by over 100%.

Enforcement Actions

In recent years, a record number of financial disclosure cases have been brought against corporations. Many have been products of the 1982 recession and the 1983 "hot new issue" market. It is during such periods that some companies - particularly small promotional companies - are tempted to "cook the books".

Market Efficiency

With a view to increasing the breadth and efficiency of the securities markets, the Commission has recently increased by 85% to 2,500 the number of over-the-counter stocks that are subject to firm quotes and last sale reports. That's nearly 1,000 more stocks than the number listed on the NYSE.

The Commission has also recently permitted:

- o the New York Stock Exchange to trade options;
- o stock exchanges and over-the-counter dealers to make competitive markets in OTC options;
- o and each of the stock exchanges to grant unlisted trading privileges in up to 25 over-the-counter stocks;
- o and has authorized a one-year pilot to test side-by-side marketmaking in the six most active OTC stocks and their related options.

These market structure innovations are being carefully monitored by the self-regulatory organizations and the SEC.

Shareholder Communications

In order to facilitate corporations' ability to communicate with their shareholders, as of January 1st of this year, brokers are required to disclose to corporations, the identity of their shareholders, who do not object. Banks will be required to begin making similar disclosures next January.

Future Developments

Important developments in prospect concern:

- o the increasing internationalization of the securities markets;
- o the immobilization of securities certificates;
- o the SEC's electronic disclosure system;
- o RICO amendments;
- o and corporate takeovers.

Internationalization

For over two centuries, the United States has been a prime beneficiary of foreign investments. During the first nine months of 1985, U.S. corporations raised a record $24 billion in the Eurobond market, as compared with only $3 billion raised in our markets by foreign companies.

Approximately 10% of the transactions on the New York Stock Exchange are now originated abroad. The SEC recently approved linkages of the Boston and Montreal and the American and Toronto stock exchanges. The National Association of Securities Dealers and the London Stock Exchange plan to disseminate quotes on over 500 securities. Reuters plans to make Instinet's execution facilities available in Europe. And other major exchanges and market systems are considering linkages.

Today, over 325 companies' shares are actively trading in more than one country. It seems inevitable that within a year or two a multiple of that will be trading around the clock and the world, through a grid of networks that interconnect the major markets.

The increasing international mobility of capital offers enormous potential benefits to corporations, investors and the global economy, but there are problems. To cite a few, U.S. shareholders of foreign corporations often suffer financial disadvantages when such companies do rights or exchange offerings. The offering materials cannot be sent to U.S. shareholders, unless they are registered here and comply with our regulations. Statutory mergers of foreign companies have been stalled or blocked, because of regulatory problems in the solicitation of acceptances from their U.S. shareholders.

There are also obstacles to the effective surveillance and enforcement of fair and orderly international markets. It is in the interest of all nations to expose and prosecute those who would use foreign secrecy and blocking laws to shield manipulation, insider trading and other illegal activities in our and other markets.

Some U.S. court decisions have been helpful. It has been held that those who play in our markets must do so by our rules and regulations. In some cases, the SEC has been able to freeze the proceeds of illicit transactions from abroad. Also, the SEC's Accord with Switzerland on insider trading is a helpful international precedent, but it is only a beginning.

With a view to addressing these and other problems, the SEC recently issued two concept releases, which suggested approaches and solicited comments on ways to facilitate the international mobility of capital, and to coordinate and improve international disclosure, distribution, surveillance and enforcement practices.

A reciprocal approach to multi-national securities offerings that is being seriously considered is initially to permit so-called "world class" corporations to do public offerings of investment grade debt securities, under prospectuses which comply with their domestic requirements, subject to certain minimum standards.

Efforts are also underway to accelerate the clearance and settlement of international transactions. And mutually acceptable international surveillance and enforcement practices are being explored here and abroad.

Immobilization of Securities Certificates

In another area, the SEC is giving impetus to long time efforts to accelerate the immobilization of securities certificates, through greater use of central depositories and electronic book-entry systems.

Over a trillion dollars of bank accounts and hundreds of billions of dollars of mutual fund shares have been on book-entry systems for years. Over half of the securities listed on the New York Stock Exchange are now immobilized in depositories, but the manual handling of the balance, as well as the mounting volume of new offerings, municipal and agency bonds and new financial instruments, is costing corporations and investors hundreds of millions of dollars per annum. And even in the absence of such potential savings, the paperwork and other problems avoided more than justify simplifying the process.

Tons of certificates are engraved and delivered daily, often by armed guards, to investors throughout the world. They are manually counted and recounted, and held in vaults and safety-deposit boxes. Multi-millions of dollars of securities certificates are lost, stolen, mutilated and counterfeited annually. Most of these expenses can be eliminated.

At SEC forums, very favorable reactions have been received from cross sections of investment, corporate and financial executives to the following voluntary approach. It only involves new issues of debt securities. It does not involve stocks and investors will not be required to turn-in any of their existing certificates.

The approach is to encourage you to do your next public offering of debt securities in the form of a single "Global Certificate" - against which investors' interests are recorded by depositories on a book-entry basis. Your savings, over the life of a 20-year $100 million bond issue are estimated at $200,000.

Your help would also be appreciated in encouraging those remaining states that limit the use of central depositories by insurance companies 1/ or state and municipal pension funds, 2/ and those that have not as yet adopted the 1977 Uniform Commercial Code amendments 3/ (which facilitate uncertificated securities interests), to update their statutes on a timely basis.

1/ Ark., Calif., La., N.M., S.D., Ut., W.Va. and Wy.

2/ N.J., Ohio, Ok., Tex. and Wy.

3/ The states that have adopted the 1977 UCC amendments are: Calif., Col., Conn., Del., Mass., Minn., Mont., N.Y., Ohio, Ok., Tex., Va., W.Va. and Wy.

Outmoded state statutes do not prevent the use of global certificates but they do impose unnecessary costs on investors.

There are many favorable developments. There have been over 30 successful public offerings of over $2 billion of book-entry money-market preferred and bond issues. Twelve states and over 20 municipalities have done public offerings of over $800 million of book-entry bond issues. IBM Credit has registered a billion dollars of debt, all or a portion of which may be sold in book-entry form.

France has commenced the conversion of all existing and new securities to an electronic book-entry system within three years.

And most important - this year the U.S. Treasury will stop issuing note and bond certificates. All future treasury securities will be issued on an electronic book-entry basis.

I do not believe securities certificates will be eliminated in the near future, but billion dollar benefits will be realized, by gradually turning off the flow of new paper into the system.

Edgar

With reference to the SEC's pilot electronic disclosure system, known as Edgar, it has been designed by the SEC staff, Arthur Andersen, IBM and Dow Jones to increase the efficiency and fairness of the securities markets, by accelerating dramatically the filing, processing, dissemination and analysis of corporate information. As reports are filed electronically with the SEC, they will be instantly accessible to investors, securities analysts and the news media on home and business computer screens. Corporate reports and other information, will be publicly available in minutes and hours, instead of days and weeks.

Edgar participants include AT&T, General Motors, IBM, Exxon and many other large and small companies, as well as the California, Georgia and Wisconsin state securities commissions. GMAC, one of the most frequent Edgar filers, has indicated that it has enabled them to get to the market faster and take advantage of market windows.

Over 180 participants have filed electronically over 2,000 documents. The pilot is being upgraded and expanded. It will be doubled in size by the end of this month, through the addition of 180 investment companies and unit investment trusts.

Subject to Congressional approvals, the Commission plans to select the prime contractor for the operational system this fall and to phase-in the 11,000 publicly-owned companies over the next three years.

RICO Amendments

With reference to the Racketeer Influenced and Corrupt Organizations Act, known as RICO, I have testified in support of major amendments that would limit the imposition of triple damages against corporations in routine commercial litigation. With the active support of the business and financial community, these overdue amendments could be enacted this year.

Corporate Takeovers

I would like to conclude with some comments on corporate takeovers. Some contend that rising institutional ownership and the threat of takeovers are forcing corporate managements to forego long-term growth programs, for short-term earnings results. Others contend that takeovers bring the disciplines of the marketplace to bear on corporate managements and accelerate the reallocation of assets, in response to changing economic conditions. There are many other reasonable contentions and valid concerns, but most lack empirical support.

A recent study by the SEC Office of the Chief Economist of tender offers from 1981 through June of last year, quantifies the benefits to shareholders. They have received an average premium of 47% over the prior market price of their shares, and the bidders' shares have risen an average of 4% net-of-the-market. 4/ The 47% average premium amounts to about $39 billion.

Corporate responses to the threat of takeovers include:

- o antitakeover charter and by-law amendments;
- o supermajority vote requirements;
- o fair price provisions;
- o recapitalizations;
- o staggered boards;
- o and "poison pills".

4/ SEC Office of the Chief Economist, "Any-or-all, Partial and Two-tier Tender Offers", 1985.

Within the past two years over 500 publicly-owned companies have proposed such measures. Over 150 of the Fortune 500 have adopted them.

With the exception of poison pills, these measures are subject to approval by the holders of at least a majority of a company's shares. It has been reported that many corporations have been dissuaded from proposing antitakeover provisions, because of anticipated shareholder opposition. Such opposition may be the reason more boards are unilaterally adopting poison pills, which do not require shareholder approval. While poison pills are intended to make a company prohibitively expensive to acquire on an unfriendly basis, they did not prevent James Goldsmith from taking over Crown Zellerbach or Pantry Pride from taking over Revlon.

The propriety of most corporate defensive tactics, including poison pills, is a matter of state - not federal law. Prior to the November Delaware Supreme Court decision, which upheld the Household International poison pill, about 30 corporations had adopted poison pills. Since then, many more corporate boards have adopted them.

In recent months, there have been a number of other important court decisions and legislative proposals, concerning:

- o one-share, one-vote requirements;
- o exclusionary tender offers;
- o the 13(d) 10-day window;
- o open market and privately negotiated purchases;
- o "greenmail";
- o "golden parachutes";
- o two-tier tender offers;
- o "junk bonds";
- o and arbitrageurs.

The National Association of Securities Dealers expects to complete its study in February of the effects of common stocks that have low voting rights on the market and investor protections. If the NASD does not raise its standards, the New York and other stock exchanges can be expected to lower theirs, subject to SEC approval - or the enactment of pending legislation, which would proscribe such capitalizations.

On January 9th, the Commission reviewed the foregoing and other takeover issues, and took the following actions.

13(d) Window

It voted to submit to Congress a simplified version of its 1985 proposal to close the 13(d) 10-day window. The proposal would reduce from 10 to 2 calendar days the filing of initial disclosures of acquisitions of 5% interests in companies.

Issuer Tender Offers

The Commission adopted rules to conform most issuer tender offer time periods to those governing third party tender offers. The Commission concluded that shareholders need the same amount of time to respond to issuer as to third party offers.

Best Price Rule

The Commission decided to repropose for public comment a revised "best-price" rule. It would require that all shareholders be paid the best price "paid" to any shareholder, rather than the best price "offered." It would permit issuers and others to reduce their offers, provided the revised offer and withdrawal rights are extended.

All Holders Rule

In response to the Unocal exclusionary tender offer, the Commission had previously proposed a rule that issuer and third party tender offers must be made to "all holders" of a class of securities. Since the "best price" and "all holders" rules are complementary, the Commission deferred action on the "all holders" rule, until it considers the revised "best price" rule.

Concept Release

The Commission also decided to seek public comments on three concepts.

The first is whether, during or immediately after a conventional tender offer, all substantial acquisitions of a target company's securities, should have to be made by a tender offer, subject to the Williams Act. Such a requirement would be intended to to address the large share acquisitions by Hanson of SCM and by Carter Hawley Hale in response to the Limited's bid.

The second is whether "poison pills" should be subject to shareholder approval.

And the third is whether corporations should be permitted to "opt-out" of the "all holders" or other Williams Act rules, if shareholders approve charter amendments which permit such actions.

Proposals Rejected

The Commission also considered a variety of other takeover issues, and unanimously concluded that the marketplace and the Commission, under its existing full disclosure and other requirements, as well as the state and federal courts are adequately addressing the following issues.

Beyond Threshold Accumulations

Specifically, the Commission concluded that requiring a party that has acquired a specified percentage of a company's shares, to effect subsequent acquisitions only by means of a tender offer, whether for any or all of the shares, is not necessary for the protection of investors and would unnecessarily burden legitimate open-market purchases.

Bidder Shareholder Approval

The Commission concluded that to require potential corporate bidders to obtain prior approval of their shareholders is a matter for state, not federal law.

Business Roundtable Proposal

With reference to the Business Roundtable's proposal that would require a bidder to submit its offer to the target's board, and if a majority of the independent directors did not approve the offer, it would be submitted to the target's shareholders for approval, and that pending their decision, the target would take no defensive actions, the Commission concluded that such an approach is not necessary for the protection of shareholders and that there is insufficient justification to preempt state law.

Two-Tier Offers

On two-tier tender offers, the Commission noted among other things that they have declined to only two last year. The Commission concluded that they and partial tender offers do not require special regulation.

Antitakeover Provisions

With reference to antitakeover charter and by-law amendments, the Commission concluded that full disclosure and shareholder approval provide adequate shareholder protections, and that there is insufficient justification to preempt state law.

Golden Parachutes

On "Golden Parachutes", the Commission noted among other things, the changes in taxation of "golden parachutes", and the availability of state law remedies, and concluded that there is insufficient justification to preempt state law.

Greenmail

On "Greenmail", the Commission noted among other things, the Disney and other shareholder suits, corporate adoption of anti-greenmail charter provisions, that payments to one encourage other greenmailers, and concluded that additional regulation is not necessary.

Lock-Ups

On "lock-ups", the Commission noted among other things, the recent Revlon and SCM decisions, and concluded that the courts can adequately address lock-ups on a case-by-case basis.

Firm Financing Commitments

With reference to the proposal that bidders be required to have "firm" financing commitments before commencing tender offers, the Commission noted among other things, the multiple conditions to "firm" financing commitments, as well as the other terms of tender offers, and determined to continue to rely on full disclosure of such terms and conditions.

Junk Bonds

The Commission declined to support proposals to prohibit or limit the use of so-called "junk bonds" to finance tender offers. The Commission has consistently rejected merit regulation of securities issues. It decided to continue to rely on full disclosures concerning such securities.

Arbitrage

The Commission also concluded that existing laws are adequate to regulate arbitrage activities.

Rumors and Trading Halts

Finally, the Commission has scheduled a February 19th Roundtable discussion with the chairmen of the New York and other stock exchanges and corporations to address the problems posed by rumors in the marketplace and trading halts, and the need for companies to make timely and appropriate disclosures.

Conclusion

In conclusion, the best defense to the threat of a takeover is of course a fairly valued stock. Corporate managements are in much better positions than outsiders to utilize their companies' enhanced borrowing capacities and asset values on a sound basis, for the benefit of their shareholders - and the vast majority are doing so.

Thank you.