
NEWS

SECURITIES AND EXCHANGE COMMISSION

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IS THE SECURITIES INDUSTRY READY
FOR REGULATORY REFORM?

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* THIS IS THE FINAL DRAFT OF COMMISSIONER KARMEL'S REMARKS. ALTHOUGH THIS DRAFT MAY BE QUOTED, IN DELIVERING HER ADDRESS THE COMMISSIONER MIGHT HAVE MADE MINOR REVISIONS IN THE TEXT. THESE ALTERATIONS, IF ANY, WILL BE REFLECTED IN THE PRINTED VERSION OF THE SPEECH WHICH WILL BE AVAILABLE FROM THE COMMISSION'S PUBLICATION UNIT IN THE NEAR FUTURE.

1.

THE FORM OF POTOMAC FEVER CURRENTLY REACHING EPIDEMIC PROPORTIONS IN WASHINGTON IS A DEREGULATION BUG. THE PRESIDENT, THE CONGRESS AND EVEN SOME OF THE REGULATORY AGENCIES ARE VYING TO DEVELOP NEW REGULATORY PROGRAMS FOR DECREASING REGULATION. THE ATTORNEY GENERAL OF THE UNITED STATES RECENTLY COMPARED THE FEDERAL BUREAUCRACY TO AN ARMY OF OCCUPATION AND CONCLUDED THAT "THE UNCHECKED GROWTH OF THE FEDERAL BUREAUCRACY MAY BE A MORTAL THREAT TO OUR HISTORIC FORMS OF GOVERNMENT. " 1/ LAST MONTH, PRESIDENT CARTER CALLED THE REGULATORY REFORM MOVEMENT "A CALL FOR COMMON SENSE," AND CRITICIZED THE AMERICAN IMPULSE TO "THROW ANOTHER LAW OR ANOTHER RULE AT EVERY PROBLEM IN OUR SOCIETY WITHOUT THINKING SERIOUSLY ABOUT THE CONSEQUENCES." 2/

THE PRESIDENT HAS MADE REGULATORY REVISION A PRINCIPAL TENET OF HIS ADMINISTRATION, AND NUMEROUS BILLS HAVE BEEN INTRODUCED IN CONGRESS AIMED AT REDUCING THE REGULATORY BURDENS ON BUSINESS. THE SECURITIES INDUSTRY, HOWEVER, HAS SEEN LITTLE OF THE GOVERNMENT'S DEREGULATORY LARGESS. TO THE CONTRARY, THE SEC HAS A NUMBER OF RULE

1/ BELL, "NOTES ON THE SITUATION: A CRITIQUE," REPRINTED AT CONG. REC. H824 (FEB. 22, 1979).

2/ RATTNER, "CARTER ANNOUNCES LEGISLATIVE PLAN TO REVISE U.S. REGULATORY PROCESS," NEW YORK TIMES, MARCH 26, 1979, P. A1, COL. 1.

PROPOSALS PENDING WHICH WOULD INCREASE THE REGULATORY BURDENS OF THE SECURITIES INDUSTRY. DURING THE PAST SIX MONTHS ALONE THE COMMISSION HAS ANNOUNCED SIGNIFICANT PROPOSALS CONCERNING THE OPTIONS MARKETS, TENDER OFFERS AND A NATIONAL MARKET SYSTEM.

I AM PERSONALLY AN ADVOCATE OF REGULATORY REFORM, AND I BELIEVE THERE ARE SOME AREAS WHERE THE SEC CAN AND SHOULD INITIATE PROPOSALS WHICH WOULD EASE THE REGULATORY BURDENS OF BROKER-DEALERS AND OTHER PARTICIPANTS IN THE SECURITIES INDUSTRY. HOWEVER, I BELIEVE IT WOULD BE UNREALISTIC FOR ANY OF US TO ASSUME THAT THE FUTURE HOLDS ANY SIGNIFICANT DEREGULATION OF THE SECURITIES INDUSTRY UNLESS THE PUBLIC, THE CONGRESS AND THE SECURITIES INDUSTRY RADICALLY CHANGE THEIR EXPECTATIONS AND ATTITUDES CONCERNING THE RELATIONS BETWEEN GOVERNMENT, BUSINESS AND THE INVESTING PUBLIC.

I AM GOING TO SPEAK TO YOU THIS MORNING ABOUT SOME OF THE REASONS WHICH MAKE IT LIKELY THAT EXTENSIVE GOVERNMENT REGULATION OF THE SECURITIES INDUSTRY WILL CONTINUE. IN THAT CONTEXT, I WILL ALSO DISCUSS AREAS WHERE NEW OR INCREASED REGULATION IS LIKELY AND AREAS WHERE SOME DEREGULATION IS POSSIBLE.

THERE ARE MANY CAUSES FOR THE PRESENT SYSTEM OF GOVERNMENT REGULATION OF BUSINESS WHICH SO MANY AMERICANS NOW PERCEIVE AS BURDENSOME AND UNWIELDY. I BELIEVE THAT ONE BASIC REASON IS THE DISINCLINATION OF AMERICANS TO DEVELOP OR AGREE UPON A COHERENT PHILOSOPHY OF GOVERNMENTAL ACTIVISM IN ECONOMIC MATTERS. FURTHER, DELEGATION OF AUTHORITY TO AN ADMINISTRATIVE AGENCY OFTEN HAS BEEN UTILIZED BY CONGRESS AS A MECHANISM FOR POLITICAL COMPROMISE IN ORDER TO AVOID PHILOSOPHICAL RESOLUTION OF FUNDAMENTAL POLICY DIFFERENCES.

THE DECISION BY THE GOVERNMENT AT THE TIME OF THE NEW DEAL TO RELY HEAVILY UPON ADMINISTRATIVE AGENCIES AS A VEHICLE FOR ECONOMIC RECOVERY AND SOCIAL REFORM WAS MORE PRAGMATIC THAN DOGMATIC. IT WAS NOT PART OF A WELL THOUGHT OUT PHILOSOPHY OF GOVERNMENTAL ACTION. THIS LACK OF AGREEMENT ABOUT THE OBJECTIVES AND THE METHODS OF REGULATION HAS CONTINUED TO THE PRESENT TIME.

AS ONE COMMENTATOR HAS OBSERVED:

THE NEAREST APPROACH OUR SOCIETY HAS MADE TO ACHIEVING SUCH A PHILOSOPHY HAS BEEN TO SECURE GENERAL AGREEMENT FOR THE PROPOSITION THAT THE APPROPRIATE EXTENT OF GOVERNMENTAL ACTIVISM IN PLANNING AND CONTROLLING THE ECONOMY LIES SOMEWHERE BETWEEN THE POLARITIES DEFINED BY ADAM SMITH AND KARL MARX. . . . THE IMPRECISION OF THE IDEOLOGY THAT JUSTIFIES THE EXISTENCE

OF ADMINISTRATIVE AGENCIES REFLECTS THE BASIC AMBIVALENCE OF OUR SOCIETY TOWARD THE PROCESS OF REGULATION. WHEN A NATION CANNOT FIND THE INTELLECTUAL WHEREWITHAL TO FORMULATE A COHERENT IDEOLOGY ON AN ISSUE AS FUNDAMENTAL TO ITS VALUES AS THE BALANCE TO BE STRUCK BETWEEN A FREE MARKET AND STATE REGULATION, SUCH REGULATION AS IT DOES AUTHORIZE WILL ALWAYS BE SUBJECT TO PHILOSOPHIC AS WELL AS PRAGMATIC QUESTION. 3/

WHEN THE SECURITIES LAWS WERE INITIALLY DRAFTED, FINANCIAL REGULATION SEEMED A MARGINAL PART OF THE NEW DEAL. UNLIKE SOME MEASURES OF THE PERIOD WHICH INVOLVED POSITIVE FEDERAL ACTION AND CONTROL OF THE ECONOMY, THE SECURITIES ACT OF 1933 SET FORTH A PROGRAM OF PROSCRIPTION. IT IMPLIED A CONCEPTION OF BUSINESS "AS AN ERRATIC AND IRRESPONSIBLE FORCE REQUIRING STRICT SOCIAL DISCIPLINE." 4/ THE SEC WAS CREATED AS A POLICEMAN FOR THE SECURITIES INDUSTRY.

THE SECURITIES LAWS WERE DESIGNED TO PUNISH MALEFACTORS AND PREVENT A REOCCURRENCE OF THE UNDUE STOCK MARKET SPECULATION OF THE 1920s, WHICH MANY BLAMED FOR THE GREAT DEPRESSION. THE EXCESSES OF THE 1960s, HOWEVER, DEMONSTRATED THAT UNDUE SPECULATION COULD NOT COMPLETELY BE PREVENTED BY SUCH REGULATION. FURTHER, THE COSTS OF THE INCREASED REGULATION OF THE 1970s, PASSED IN RESPONSE TO THE EXCESSES OF THE 1960s IS BEGINNING TO BE APPRECIATED. THIS IS ONE OF THE

3/ FREEDMAN, "CRISIS AND LEGITIMACY IN THE ADMINISTRATIVE PROCESS," 27 STANFORD L.REV. 1041, 1053-54 (1975).

4/ SCHLESINGER, "THE COMING OF THE NEW DEAL" 444 (1959).

5.

FACTORS WHICH HAS LED TO A QUESTIONING OF THE OBJECTIVES AND METHODS OF FEDERAL SECURITIES REGULATION.

IN THIS RE-EXAMINATION, THERE HAS BEEN AN INCREASING FOCUS ON THE EFFECT OF SECURITIES REGULATION ON CAPITAL FORMATION. THE SECRETARY OF THE TREASURY HAS STATED THAT THE CARTER ADMINISTRATION "WILL BE REEVALUATING THE EFFICIENCY WITH WHICH OUR PUBLIC SECURITIES MARKETS MEET THE NEEDS OF SAVERS, BORROWERS, AND RISK-TAKERS." HE CONTEMPLATED THAT THE SEC WOULD BE A CONTRIBUTOR TO THIS REVIEW BECAUSE "THE REPUTATION THAT THE SEC HAS EARNED FOR FIERCELY GUARDING THE RIGHTS OF THE INVESTING PUBLIC IS A MAJOR ELEMENT IN OUR SUCCESS IN TRANSFORMING THE SAVINGS OF INDIVIDUALS INTO THE FINANCING OF PRIVATE INVESTMENT." 5/

THIS SHIFT IN EMPHASIS WITH REGARD TO THE OBJECTIVES OF SECURITIES REGULATION IS INTERESTING AND IMPORTANT. THE ASSUMPTION THAT EVEN IF THE PRIORITIES OF A REGULATORY SCHEME CHANGE, INDEPENDENT REGULATORY AGENCIES LIKE THE SEC WILL CONTINUE THEIR OPERATIONS IS ALSO INTERESTING AND IMPORTANT. I BELIEVE THIS ASSUMPTION IS VALID. DESPITE THE POPULAR APPEAL OF DEREGULATION, THE MACHINERY OF GOVERNMENT IS GEARED FOR INCREASING REGULATION.

5/ BLUMENTHAL, "THE GOVERNMENT'S ROLE IN THE CAPITAL FORMATION PROCESS," IN KUEHNER (ED.) CAPITAL AND JOB FORMATION 313 (1978).

SOME CURRENT PROGRAMS FOR REGULATORY REFORM DO INVOLVE TRUE DEREGULATION. ONE IS THE CAB'S PROGRAM FOR AIRLINE DEREGULATION. ANOTHER IS THE SEC'S REEXAMINATION OF ITS REGULATIONS UNDER THE INVESTMENT COMPANY ACT OF 1940. BUT MOST CURRENT PROPOSALS FOR REGULATORY REFORM INVOLVE MANAGEMENT AND CONTROL OF THE REGULATORY PROCESS -- THE IMPOSITION OF REGULATIONS UPON THE REGULATORS. IN ADDITION, THE FEDERAL BUREAUCRACY IS A POWERFUL SPECIAL INTEREST GROUP, WHICH WILL NOT GLADLY SUFFER AN END TO GOVERNMENT PROGRAMS.

MUCH OF FEDERAL REGULATION IS NOT ONLY JUSTIFIED BUT VITALLY IMPORTANT TO MODERN SOCIETY. HISTORY HAS DEMONSTRATED THAT MANY SOCIALLY AND ECONOMICALLY DESIRABLE GOALS CANNOT BE ACHIEVED THROUGH MARKET FORCES ALONE. ADMINISTRATIVE AGENCIES, ESPECIALLY THE INDEPENDENT REGULATORY AGENCIES, ARE AN EXISTING MECHANISM WHICH THE GOVERNMENT CAN UTILIZE TO IMPLEMENT NEW ECONOMIC AND SOCIAL PROGRAMS. ONE EXAMPLE, OF OBVIOUS INTEREST TO THIS AUDIENCE, IS THE FACT THAT IN 1975 THE CONGRESS GREATLY INCREASED THE REGULATORY ARSENAL OF THE SEC, PARTICULARLY WITH RESPECT TO OVERSIGHT OF THE SECURITIES INDUSTRY.

I BELIEVE THAT WE ARE PRESENTLY AT A CROSS ROADS WHERE GOVERNMENT REGULATION OF BUSINESS GENERALLY, AND THE SECURITIES INDUSTRY PARTICULARLY, COULD TAKE DIFFERENT DIRECTIONS. REGULATORY PURPOSE AND METHODOLOGY ARE BEING QUESTIONED BY MANY, AND THE SEC IS AN ENERGETIC AND RESPONSIVE AGENCY, LIKELY TO ADAPT TO CHANGING NEEDS. BUT, I AM NOT AS OPTIMISTIC AS I WOULD LIKE TO BE THAT THE COMMISSION WILL TAKE A DEREGULATORY ROAD RESPECTING THE SECURITIES INDUSTRY.

ONE REASON IS THAT THE INDUSTRY HAS EVIDENCED A VERY STRONG DISINCLINATION FOR COMPETITION AS AN ALTERNATIVE TO REGULATION.

ONCE ESTABLISHED, REGULATION TENDS TO SPAWN AND THEN PROTECT CERTAIN GROUPS, WHICH THEN HAVE A VESTED INTEREST IN ITS CONTINUATION. THE NECESSITY FOR CONTROLLING A NATURAL MONOPOLY HAS BEEN AND CONTINUES TO BE A MAJOR JUSTIFICATION FOR FEDERAL REGULATION. HOWEVER, A RECENT STUDY BY THE SENATE COMMITTEE ON GOVERNMENTAL AFFAIRS INDICATES THAT THERE ARE FEW TRUE NATURAL MONOPOLY SITUATIONS. PERSONALLY, I AM NOT CONVINCED THAT THE SECURITIES INDUSTRY IS OR WILL BECOME A MONOPOLY DESPITE SOME VERY DISTURBING CURRENT TRENDS TOWARD INCREASED CONCENTRATION. MODERN COMMUNICATIONS AND DATA PROCESSING UNDERMINE THE HISTORICAL ARGUMENTS THAT EXCHANGES ARE NATURAL MONOPOLIES. IN ANY EVENT, OVERREGULATION RESULTS IN EVILS SIMILAR TO UNREGULATED MONOPOLY POWER, -- HIGHER PRICES, PROTECTION OF INEFFICIENCY, A STIFLING OF INNOVATION AND THE CREATION OF UNREASONABLE ENTRY BARRIERS. 6/

I FREQUENTLY HEAR TIRADES FROM REPRESENTATIVES OF THE SECURITIES INDUSTRY ABOUT OVERREGULATION. SUCH COMPLAINTS MORE OFTEN THAN NOT INCLUDE AN ATTACK ON THE GOVERNMENT FOR THE UNFIXING OF STOCK EXCHANGE COMMISSION RATES. I AM ALWAYS BEMUSED BY THIS COMPLAINT. THE UNFIXING OF COMMISSION RATES WAS INTENDED BY CONGRESS AND THE COMMISSION AS DEREGULATION

6/ STUDY ON FEDERAL REGULATION, SENATE COMMITTEE ON GOVERNMENTAL AFFAIRS, VOL. VI, PP. XII-XIX, 49-50, 95TH CONG., 2D SESS. (1978),

OF THE SECURITIES INDUSTRY. IT MAY BE VIEWED AS A PRECURSOR OF AND MODEL FOR THE DEREGULATION OF OTHER INDUSTRIES, SUCH AS AIRLINES.

THE STATUTORY RESPONSIBILITIES GIVEN TO THE COMMISSION BY THE CONGRESS IN 1975 TO FACILITATE THE DEVELOPMENT OF NATIONAL MARKET AND CLEARANCE AND SETTLEMENT SYSTEMS HAVE RESULTED AND WILL RESULT IN INCREASED REGULATION OF THE SECURITIES INDUSTRY BY THE SEC. LAST MONTH THE COMMISSION ISSUED A STATUS REPORT ON THE NATIONAL MARKET SYSTEM, REVIEWING THE RULEMAKING PROPOSALS OF THE PAST YEAR AND THEIR RESULTS AND OUTLINING FUTURE RULEMAKING INITIATIVES. I FULLY SUPPORT THE COMMISSION'S POSITIONS ON THE VARIOUS PROBLEMS WHICH MUST BE WORKED THROUGH TO ACHIEVE THE STATUTORY MANDATES OF THE 1975 AMENDMENTS. HOWEVER, THE DIRECTION THE COMMISSION IS TAKING, AND IS REQUIRED TO TAKE BY REASON OF CONGRESS'S DIRECTIVES IS TOWARD MORE, NOT LESS, REGULATION.

ONE REASON WHY THE SEC HAS BEEN UNABLE TO DEREGULATE THE SECURITIES MARKETPLACE IS THAT THE INDUSTRY HAS INSISTED THAT CERTAIN ANTI-COMPETITIVE PRACTICES ARE ESSENTIAL TO THE MAINTENANCE OF FAIR AND ORDERLY MARKETS. OFF-BOARD TRADING RESTRICTIONS ARE THE MOST OBVIOUS, BUT BY NO MEANS THE ONLY EXAMPLE OF INDUSTRY RESISTANCE TO COMPETITION AS AN ALTERNATIVE TO REGULATION. SECTION 11(A) OF THE SECURITIES EXCHANGE ACT OF 1934 CONCERNING THE EXECUTION OF EXCHANGE TRANSACTIONS BY MEMBERS IS ANOTHER EXAMPLE OF A REGULATION WITH ANTI-COMPETITIVE UNDERPINNINGS.

NOW IT MAY WELL BE THAT THESE RESTRICTIONS ARE NECESSARY AND APPROPRIATE AND THEREFORE WHATEVER BURDENS THEY IMPOSE UPON COMPETITION ARE JUSTIFIED. FURTHER, I AM NOT SAYING THAT COMPETITION AT VARIOUS LEVELS DOES NOT EXIST IN THE SECURITIES INDUSTRY. AS THIS AUDIENCE IS WELL AWARE, THERE IS MUCH GREATER COMPETITION TODAY THAN A DECADE AGO. BUT THE SECURITIES INDUSTRY MUST RECOGNIZE THAT THE PRICE IT IS PAYING FOR THE CONTINUATION OF THE MANY ANTI-COMPETITIVE ATTITUDES AND PRACTICES WHICH REMAIN IS INCREASED GOVERNMENT OVERSIGHT OF ITS ACTIVITIES. FURTHER, SUCH REGULATION ALWAYS HAS A HIGH PRICE TAG.

THE COMMISSION AND THE INDUSTRY HAVE BEEN ENGAGED IN A CONTINUING DIALOGUE ON THESE MATTERS THROUGHOUT THE 1970s AND IT APPEARS THAT THIS DIALOGUE WILL CONTINUE INTO THE 1980s. IN ITS RECENT NATIONAL MARKET SYSTEM STATUS REPORT THE COMMISSION ANNOUNCED THAT IT WOULD COMMENCE A RULEMAKING PROCEEDING TO DETERMINE WHETHER OFF BOARD TRADING RESTRICTIONS SHOULD BE LIFTED WHENEVER A SECURITY WHICH HAS BEEN TRADING IN THE OVER-THE-COUNTER MARKETS BECOMES LISTED ON AN EXCHANGE. IT IS ANTICIPATED THAT A RULE PROPOSAL TO THIS EFFECT WILL BE MADE IN THE NEAR FUTURE. I HOPE THAT INDUSTRY RESPONSE TO SUCH A PROPOSAL WILL TAKE INTO ACCOUNT THE REGULATORY ALTERNATIVES INVOLVED.

COMPETITION AS AN ALTERNATIVE TO REGULATION IS NOT A PANACEA -- AS THE EXPERIENCE WITH UNFIXED COMMISSION RATES HAS DEMONSTRATED. NEVERTHELESS, THE EVILS OF REGULATING A MONOPOLY MAY MAKE SUCH DEREGULATION THE BEST ALTERNATIVE AVAILABLE IN MANY SITUATIONS.

I CONTINUE TO BELIEVE THAT THE KIND OF RATE MAKING IN WHICH THE COMMISSION WOULD HAVE HAD TO ENGAGE TO PRESERVE FIXED MINIMUM COMMISSION RATES WOULD BE WORSE THAN THE VERY REAL PROBLEMS ENGENDERED BY UNFIXED RATES.

NOT ALL OF THE INCREASED SECURITIES REGULATION LOOMING ON THE HORIZON IS A RESPONSE TO MONOPOLY POWER. SOME OF IT IS A RESPONSE TO PERCEIVED ABUSES. ONE IMMEDIATE AND SIGNIFICANT EXAMPLE IS THE COMMISSION'S PENDING PROPOSALS TO FURTHER REGULATE TENDER OFFERS. 7/ OF EVEN MORE IMMEDIACY TO THIS AUDIENCE IS THE COMMISSION'S PROGRAM FOR ENDING THE OPTIONS MORATORIUM BY GREATLY INCREASING THE REGULATION OF OPTIONS SELLING AND TRADING. 8/ THE ABUSES TO WHICH THESE REGULATIONS ARE ADDRESSED ARE REAL. IN THE CASE OF OPTIONS THEY HAVE BEEN SET FORTH IN THE REPORT OF THE SPECIAL STUDY OF THE OPTIONS MARKETS. HOW SUCH REGULATION CAN BE JUSTIFIED IN AN ADMINISTRATION AND A CONGRESS WHICH EVERY DAY ARE CALLING FOR DEREGULATION IS ANOTHER MATTER.

7/ SECURITIES ACT RELEASE No. 6022 (FEB. 5, 1979).

8/ SECURITIES EXCHANGE ACT RELEASE No. 15575 (FEB. 22, 1979)

I POINTED OUT EARLIER THAT THE RELATIONSHIP OF SECURITIES REGULATION TO CAPITAL FORMATION IS RECEIVING INCREASED ATTENTION. AN ARGUMENT CAN BE MADE THAT SPECIAL REGULATION OF THE OPTIONS MARKETS IS JUSTIFIED BECAUSE OPTIONS DO NOT DIRECTLY ASSIST CAPITAL FORMATION. TENDER OFFERS MAY BE SIMILARLY SUSPECT. I AM WELL AWARE, HOWEVER, THAT THE VALUE OF OPTIONS AND TENDER OFFERS TO THE GENERAL ECONOMY HAS BEEN TESTIFIED TO BY MANY.

FURTHER, IT MAY BE ARGUED THAT RESOURCE ALLOCATION IS NOT THE GOVERNMENT'S BUSINESS OR FORTE. HOWEVER, THERE IS SOME JUSTIFICATION IN THE LEGISLATIVE HISTORY OF THE SECURITIES EXCHANGE ACT OF 1934 FOR MAKING REGULATORY JUDGMENTS BASED ON THE CHANNELING OF CAPITAL INTO PREFERRED SECTORS OF THE FINANCIAL MARKETS. THE MARGIN RULES, SHORT SELLING RULES AND PLENARY AUTHORITY OF THE COMMISSION OVER OPTIONS TRADING SET FORTH IN THE EXCHANGE ACT WERE ALL COMPROMISES. MANY LEGISLATORS WANTED TO ELIMINATE MARGIN TRANSACTIONS, SHORT SELLING AND OPTIONS TRADING FROM THE SECURITIES MARKETS BECAUSE SUCH PRACTICES WERE THOUGHT TO BE INIMICAL TO "LEGITIMATE" INVESTMENT. IN THIS CONNECTION, I SHOULD NOTE THAT THE SEC'S EFFORTS TO DEREGULATE SHORT SELLING HAVE MET WITH STRONG RESISTANCE.

THE SECURITIES INDUSTRY TENDS TO CRITICIZE ITS REGULATORS WHEN CONSIDERATIONS ABOUT CAPITAL FORMATION RESULT IN NEW REGULATION. AT THE SAME TIME, I FREQUENTLY HEAR

DEMANDS BY THE SECURITIES INDUSTRY FOR A PROMOTER IN WASHINGTON AND FOR GOVERNMENT REGULATION WHICH WOULD ASSIST THE CAPITAL RAISING FUNCTIONS OF THE INDUSTRY. PERSONALLY, I AM NOT VERY SYMPATHETIC TO SUCH DEMANDS. A RECENT SENATE STUDY HAS CONCLUDED THAT

IN GENERAL, THERE APPEARS TO BE LITTLE JUSTIFICATION FOR REGULATION TO PREVENT "DESTRUCTIVE" COMPETITION, CONTROL COMPETITORS, PROMOTE "KEY" INDUSTRIES, INSURE SERVICE TO PARTICULAR COMMUNITIES OR GROUPS THROUGH CROSS SUBSIDIES, OR TO PRESERVE PROPERTY RIGHTS. ^{9/}

YET IT IS JUST SUCH PROMOTIONAL REGULATION WHICH THE SECURITIES INDUSTRY WOULD LIKE.

I WOULD ALIGN MYSELF WITH THOSE ADVOCATES OF DEREGULATION WHO ARGUE THAT REGULATION FOR THE PURPOSE OF FOSTERING OR PROTECTING A PARTICULAR INDUSTRY HAS NOT WORKED OUT VERY WELL AND HAS NOT ULTIMATELY BENEFITED THE PUBLIC. ON THE OTHER HAND, REGULATION CERTAINLY SHOULD NOT UNNECESSARILY HOBBLE AN INDUSTRY OR, IN THE CASE OF THE SECURITIES INDUSTRY, INTERFERE WITH ITS CAPITAL RAISING FUNCTIONS.

THE CHAIRMAN'S LETTER OF TRANSMITTAL ACCOMPANYING THE 1977 ANNUAL REPORT OF THE SEC POINTS OUT THAT

CONGRESS'S FUNDAMENTAL OBJECTIVE IN ENACTING THE FEDERAL SECURITIES LAWS WAS TO PROMOTE PUBLIC CONFIDENCE IN THE SECURITIES MARKETS IN ORDER TO FOSTER THE VITAL PROCESS BY WHICH THE CAPITAL IS MARSHALLED FROM THE PUBLIC AND CHANNELLED INTO GROWTH OF OUR ECONOMY.

^{9/} SENATE STUDY, NOTE 6 SUPRA, AT 293.

CHAIRMAN WILLIAMS EXPLAINS THAT ONE CONSEQUENCE OF THE INTERRELATIONSHIP BETWEEN INVESTOR CONFIDENCE AND CAPITAL FORMATION IS THAT THE SEC MUST ENSURE THAT COMMISSION REGULATION UNDER THE SECURITIES LAWS DOES NOT INADVERTENTLY IMPAIR CAPITAL FORMATION. FURTHER, ALTHOUGH THE COMMISSION IS NOT CHARGED WITH MAINTAINING THE ECONOMIC HEALTH OF THE SECURITIES INDUSTRY, THE LETTER OF TRANSMITTAL ACKNOWLEDGES THAT

WE HAVE AN OBVIOUS RESPONSIBILITY TO UNDERSTAND, THE INDUSTRY'S ECONOMIC CONDITION AND TO ENDEAVOR TO ENSURE THAT THE COMMISSION'S DISCHARGE OF ITS REGULATORY RESPONSIBILITIES IS NOT INCONSISTENT WITH A FINANCIALLY STRONG AND STABLE INDUSTRY.

ONE AREA WHERE THE COMMISSION IS GRAPPLING WITH IDEAS FOR REGULATORY REFORM INVOLVES A REEXAMINATION OF THE SEC'S FINANCIAL RESPONSIBILITY RULES APPLICABLE TO BROKER-DEALERS. THE COMMISSION'S NET CAPITAL AND CUSTOMER PROTECTION RULES ARE VERY IMPORTANT PROTECTIONS FOR THE INVESTING PUBLIC AGAINST WEAK CAPITALIZATION OR UNSOUND BACK OFFICE PRACTICES BY BROKER-DEALERS.

AT THE TIME THESE RULES WERE ADOPTED, THE COMMISSION WAS PRIMARILY CONCERNED WITH THE RISKS INHERENT IN A RETAIL MARGIN-CUSTOMER ORIENTED INDUSTRY. IN RECENT YEARS THERE HAS BEEN A SHIFT TOWARD LARGE INSTITUTIONAL C.O.D. ACCOUNTS. IN PARTICULAR, LARGE GOVERNMENT SECURITIES TRANSACTIONS ARE HANDLED ON A C.O.D. BASIS. THE SECURITIES INDUSTRY HAS THEREFORE RAISED THE ISSUE OF WHETHER IT IS

SUBJECT TO UNDUE CAPITAL REQUIREMENTS UNDER WHICH BROKER-DEALERS ARE BEING FORCED TO HAVE UNNECESSARILY LARGE AMOUNTS OF "REGULATORY CAPITAL," OR CAPITAL WHICH SERVES NO BUSINESS PURPOSE. IN AN INFLATIONARY, HIGH INTEREST PERIOD, THE MAINTENANCE OF SUCH CAPITAL HAS AN ADVERSE EFFECT ON BROKER-DEALER PROFITABILITY.

THE SIA IS NOW REEXAMINING THE NET CAPITAL RULE TO DETERMINE WHETHER IT IS UNNECESSARILY ONEROUS, AND THE COMMISSION'S STAFF IS FOLLOWING THIS REEXAMINATION. THIS REVIEW IS PARTICULARLY FOCUSING ON THE PERCENTAGE REQUIREMENTS AND RESERVE FORMULA DEBITS UNDER THE ALTERNATIVE NET CAPITAL RULE. I AM NOT IN A POSITION TO PREDICT WHAT THE OUTCOME OF THIS REVIEW WILL BE, BUT I THINK IT IS IMPORTANT THAT IT IS TAKING PLACE, AND THAT THE SEC HAS INDICATED A RECEPTIVENESS TO CONSIDER THE CONCLUSIONS WHICH THE SIA REACHES.

ANOTHER REGULATORY REFORM EFFORT WHICH HAS BEEN ONGOING FOR SOME TIME INVOLVES UNIFORM FINANCIAL REPORTING BY BROKER-DEALERS. IN 1974, THE REPORT COORDINATING GROUP, A FEDERAL ADVISORY COMMITTEE, WAS FORMED TO DEVELOP AMONG OTHER THINGS, UNIFORM FINANCIAL REPORTING FORMS FOR BROKER-DEALERS. ONE OF THE RECOMMENDATIONS OF THE GROUP WHICH THE SEC ADOPTED WAS THE FINANCIAL AND OPERATIONAL COMBINED UNIFORM SINGLE REPORT -- KNOWN TO MOST OF YOU AS THE FOCUS REPORT. THE FOCUS REPORT SIMPLIFIED AND CONSOLIDATED INTO ONE REPORTING FORM THE REPORTING REQUIREMENTS OF FORM X-17A-10, FORM X-17A-11, FORMS "M" AND "Q", THE

JOINT REGULATORY REPORT, THE INCOME AND EXPENSE REPORTS, AS WELL AS VARIOUS OTHER FINANCIAL AND OPERATIONAL FORMS AND REPORTS REQUIRED BY THE SELF-REGULATORY ORGANIZATIONS.

THE FOCUS REPORT HAS RESULTED IN SIGNIFICANT COST SAVINGS FOR BROKER-DEALERS, WITHOUT ANY IMPAIRMENT OF REGULATORY OBJECTIVES. IT IS A FINE EXAMPLE OF THE KIND OF IMPROVED REGULATORY MANAGEMENT AND REDUCTION OF THE PAPERWORK BURDEN ON BUSINESS WHICH THE CARTER ADMINISTRATION IS ADVOCATING. MOREOVER, THE COMMISSION IS CONTINUING TO REVIEW THE FOCUS REPORT TO DETERMINE WHETHER REQUIRED ITEMS CONTINUE TO BE NECESSARY TO MONITOR THE CONDITION OF BROKER-DEALERS AND THE INDUSTRY GENERALLY.

LAST MONTH THE COMMISSION PUBLISHED AN AGENDA OF ANTICIPATED MAJOR RULEMAKING AND RELATED MATTERS LIKELY TO BE CONSIDERED DURING THE BALANCE OF 1979. 10/ THAT AGENDA CONTAINS TWO REGULATORY REFORM ITEMS IN ADDITION TO THOSE I HAVE ALREADY MENTIONED THIS MORNING WHICH MAY BE OF PARTICULAR INTEREST TO THIS AUDIENCE. THE COMMISSION MAY CONSIDER A RULE PROPOSAL UNDER SECTION 12(F) OF THE SECURITIES EXCHANGE ACT OF 1934 GOVERNING THE INFORMATION TO BE SUPPLIED IN APPLICATIONS FOR UNLISTED TRADING PRIVILEGES AND ENUNCIATING THE STANDARDS IN REVIEWING SUCH APPLICATIONS. IN ADDITION,

10/ SECURITIES ACT RELEASE No. 6040 (MARCH 22, 1979).

LAST WEEK THE COMMISSION APPROVED THE ISSUANCE OF PROPOSALS TO AMEND RULE 19B-4 UNDER THE SECURITIES EXCHANGE ACT OF 1934. THIS IS AN EFFORT DESIGNED TO ENHANCE THE EFFICIENCY OF THE COMMISSION'S OVERSIGHT OF SELF-REGULATORY ORGANIZATIONS.

RULE 19B-4 SPECIFIES THE PROCEDURES THAT SELF-REGULATORY ORGANIZATIONS MUST FOLLOW IN FILING PROPOSED RULE CHANGES WITH THE COMMISSION. FOR SOME TIME, IT HAS SEEMED TO ME THAT RULE 19B-4 AND THE WAY IT HAS BEEN IMPLEMENTED SHOULD BE CHANGED IN ORDER FOR COOPERATIVE SELF REGULATION TO CONTINUE TO BE A VIABLE ALTERNATIVE TO DIRECT GOVERNMENT REGULATION OF THE SECURITIES INDUSTRY. A MEETING TO DISCUSS THE PROBLEMS WHICH HAVE ARISEN UNDER RULE 19B-4 WAS HELD AT THE SEC IN JUNE 1978 WHICH WAS ATTENDED BY REPRESENTATIVES FROM THE SROs. THEREAFTER THE COMMISSION RECEIVED SEVERAL THOUGHTFUL LETTERS CONTAINING SUGGESTIONS FOR CHANGE, SOME OF WHICH HAVE BEEN INCORPORATED IN THE SEC'S RECENT RULE PROPOSALS. BROKER-DEALERS HAVE GENERALLY LEFT THE PROBLEMS OF PROCESSING RULE FILINGS TO THE SROs AND THE SEC. HOWEVER, THE INDUSTRY IS DIRECTLY AFFECTED BY SUCH REGULATION, AND THE COSTS OF A SYSTEM WHICH IS SLOW AND CUMBERSOME IS PAID FOR BY THE INDUSTRY AND ULTIMATELY ITS CUSTOMERS. I THEREFORE URGE YOU TO FOCUS ON THESE PROPOSALS AND COMMENT UPON THEM.

IN SPEAKING TO YOU THIS MORNING ABOUT SO MANY DIFFERENT CURRENTLY PENDING REGULATORY PROPOSALS, I HAVE RUN THE RISK OF BEING SUPERFICIAL AND CONFUSING. BUT I THINK IT IS IMPORTANT FOR YOU TO REALIZE THAT SECURITIES REGULATION IS TODAY IN A STATE OF UPHEAVAL, IN RESPONSE BOTH TO CHANGING, AND CONTRADICTORY, POLITICAL TRENDS AND TO A RAPIDLY CHANGING INDUSTRY. AND I SEE GREATER UPHEAVAL AHEAD.

GOVERNMENT REGULATION HAS NOT REALLY KEPT PACE WITH THE CHANGES OCCURRING IN THE FINANCIAL MARKETS AND FINANCIAL INSTITUTIONS. FURTHER, THE PRESENT ADMINISTRATION HAS RECOGNIZED THAT IT IS IMPORTANT TO INQUIRE WHETHER THE PANOPLY OF GOVERNMENT LEGISLATION AND REGULATION IS HELPING OR HINDERING THE ACHIEVEMENT OF MAXIMUM EFFICIENCY IN THE TRANSFORMATION OF SAVINGS INTO INVESTMENT. 11/ IT IS ONLY A QUESTION OF TIME BEFORE THE CONGRESS REEXAMINES THE CONTINUING VALIDITY OF DIFFERING REGULATION OF FINANCIAL INTERMEDIARIES MANDATED BY THE GLASS-STEAGALL ACT AND OTHER STATUTES. IT IS ALSO LIKELY THAT IN THE PRESENT OVERSIGHT MOOD OF THE CONGRESS THAT SECURITIES REGULATION WILL BE REVIEWED BY WAY OF LEGISLATIVE HEARINGS ON THE ALI'S FEDERAL SECURITIES CODE.

11/ BLUMENTHAL, NOTE 5 SUPRA, AT 312.

SUCH DEVELOPMENTS COULD HAVE FAR REACHING CONSEQUENCES FOR THE SECURITIES INDUSTRY. BUT WHETHER THE INDUSTRY IS READY FOR REGULATORY REFORM IS ANOTHER MATTER. REAL DEREGULATION NECESSARILY INVOLVES RISK AND CHANGE. REAL ALTERNATIVES TO DIRECT GOVERNMENT REGULATION NECESSARILY REQUIRE INTELLIGENT AND CREDIBLE BUSINESS LEADERSHIP. I HOPE THAT THE SECURITIES INDUSTRY WILL MEET THESE CHALLENGES SO THAT IT WILL DEMAND AND TAKE ADVANTAGE OF REGULATORY REFORM.