

# NEWS

## SECURITIES AND EXCHANGE COMMISSION

Washington, D. C. 20549

(202) 272-2650



### CURRENT CONCERNS OF THE COMMISSION

Remarks to

The Brookings Institution

Conference for Business Executives on

Understanding Federal Government Operations

Washington, D. C.

February 5, 1985

Charles C. Cox  
Commissioner

Securities and Exchange Commission  
Washington, D. C.

---

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

Good afternoon.

I'm pleased to have the opportunity to address such a distinguished audience. Today, I'd like to touch briefly on some matters of current concern to the Commission.

Before I begin, however, let me tell you a little bit about the SEC. The Commission is an independent regulatory agency which is charged with administering and enforcing the federal securities laws. It is composed of five members, no more than three of which can be from the same political party. The Commissioners are assisted by a staff of 2046 professional and support persons, 1329 of which are based in the home office and 717 of which work in the nine regional and six branch offices.

Much of the Commission's work is accomplished through its operating divisions. The Division of Corporation Finance is primarily responsible for administering the Commission's mandatory disclosure system; the Division of Market Regulation handles issues involving the structure of the securities markets and the activities of securities professionals; the Division of Investment Management administers the rules and regulations involving investment companies, investment advisers and public utility holding companies; the Office of the Chief Accountant has primary responsibility for administering the Commission's accounting related rules and acts as liaison to the standard-setting bodies established by the private sector whose activities the Commission oversees; and the Division of Enforcement investigates and requests authorization to prosecute violations of the federal securities laws. Among the Commission's other offices are the Office of the General Counsel, which provides legal advice to the Commission and the other Divisions, and the Office of the Chief Economist, which provides economic analysis.

Turning to the current concerns of the Commission, I'd like to start with an area emanating from the Division of Corporation Finance that I'm sure you're all familiar with -- the regulation of tender offers. Over the past two years, there has been much debate about the economic implications of the tender offer process and the extent to which the tactics of bidders and targets should be regulated. As administrator of the Williams Act, the Commission thought it wise to study these issues and, in February 1983, established the Advisory Committee on Tender Offers.

The Committee's Report was submitted to the Commission in July 1983 and contained fifty recommendations covering many aspects of the tender offer process. Overall, the Committee thought that there were insufficient data to conclude that takeovers either help or hurt the securities markets or the economy in general. Thus, the Committee concluded that the regulatory scheme should be designed neither to promote nor to deter takeovers.

In response to the Committee's Report, the Commission submitted to Congress in May 1984 tender offer legislation which, in its view, addressed particularly abusive takeover practices without unduly intruding into the area of state law. This legislation would amend the Securities Exchange Act of 1934 to proscribe, during bona fide tender offers by third parties, the granting of golden parachutes, the reacquisition of shares through self-tender offers or open market purchases and dilutionary financings. It also would prohibit greenmail transactions and would authorize the Commission to close the existing "ten-day window" for Schedule 13D filings.

The Tender Offer Reform Act, as proposed by the Commission, was introduced both in the House and the Senate, and portions of the bill were modified and added to other House and Senate bills. In addition to the Commission's bill, other, and somewhat more drastic, proposals to regulate takeovers were introduced in the House and Senate. One bill would have created a federal cause of action to challenge corporate management decisions related to change of control transactions. Another bill proposed to restrict or prohibit partial or two-tier tender offers by prohibiting persons from acquiring more than ten percent of the stock of a company unless that person offered to purchase all of the company's stock at the same price. None of these measures was enacted before Congress adjourned last year. Senate hearings on tender offer reform most likely will be held in late February or early March and House hearings are planned at about the same time. Both sets of hearings will focus on the broad issues involved in tender offer regulation rather than on specific legislative proposals. For that reason, it appears unlikely that any comprehensive tender offer legislation will be enacted this year.

The Commission's Office of the Chief Economist has been particularly active in the takeover area and has conducted a number of studies which should assist the Commission and the public in resolving these sometimes difficult and complex questions. For example, a study on the economic effects of antitakeover charter amendments found evidence to support the hypothesis that shark repellents reduce shareholder wealth. Specifically, among the 87 New York Stock Exchange (NYSE) and American Stock Exchange (Amex) listed companies that adopted fair price and super-majority provisions from 1980 to 1983, following announcement of such proposals, the value of their shares declined between 2% and 3% on average relative to the overall stock market. And, the value of the shares of forty companies traded in the over-the-counter (OTC) market declined an average of 5% more than the market. The decline in the market value of the stock of these 127 companies totaled over \$1 billion.

Other studies conducted by the Office of the Chief Economist focus on the impact of greenmail on target-share prices and the economics of partial and two-tier tender offers. In addition, that office is planning to host an economic forum at the Commission

in late February where academic economists and economists representing corporate America will discuss economic aspects of tender offers.

Also in the disclosure area, the Division of Corporation Finance is continuing in its efforts to streamline and rationalize the mandatory disclosure system. As part of its continuing Proxy Review Program, the Division is conducting a sunset review of Regulations 14A, and 14C, the proxy regulations. The existing proxy rules were adopted piecemeal and have been the subject of frequent changes. Some of their requirements are duplicative and may create unnecessary burdens on investors and registrants. The review is intended to identify unnecessary requirements and areas which require clarification for the benefit of investors.

In addition, the Division is conducting a review of the beneficial ownership rules under Section 16 of the Securities Exchange Act of 1934. Section 16 seeks to deter misuse of inside information by imposing certain periodic and transactional reporting requirements on the officers, directors, and principal beneficial shareholders of companies registered under that Act as well as certain limitations on equity transactions by those persons. Over the years, the Commission has adopted a number of rules and forms to clarify the applicability of Section 16's requirements to particular circumstances. Many of these rules are technical and complex. The Commission will examine their current suitability in light of the purposes of the statute.

Turning from disclosure to Market Regulation, another area of concern to the Commission, and one which relates to tactics employed by potential takeover targets, is listing standards. In the past year, approximately 400 companies, including many Fortune 500 companies, have implemented defensive measures which limit shareholders' voting rights. An additional 600 companies are expected to adopt such defensive measures in the coming year.

This rush to implement defensive measures has exerted pressures upon some self-regulatory organizations (SROs) such as the NYSE to revise their listing standards. As you are probably aware, the listing standards of the NYSE are the most stringent of the SROs, in essence requiring one vote for one share of common stock. These shareholder participation rules are designed to assure stockholders of the right to vote their proportionate equity interest in the company and to approve certain corporate transactions. On the other hand, the Amex's listing standards provide a lesser extent of shareholder protection regarding proportional voting representation while the National Association of Securities Dealers (NASD) rules applicable to securities traded on NASDAQ provide none. Thus, while many defensive tactics (e.g., multiple classes of common stock with disproportionate voting rights) would violate NYSE listing standards, they may be permissible under NASDAQ or Amex listing standards.

In the past, the NYSE's dominance in the equities market and the attractiveness of a listing on the "Big Board" have enabled the NYSE to demand compliance with its shareholder participation rules primarily through a threat of delisting. Recently, however, because NASDAQ and Amex represent viable market alternatives to the NYSE, issuers desiring to adopt certain defensive measures which would violate NYSE listing standards have been willing to adopt such measures and either remain on NASDAQ or Amex or risk being delisted from the NYSE.

Faced with this competitive pressure, in July of last year, the NYSE imposed an informal moratorium on delisting and announced that it would conduct a major review of its listing standards relating to tender offers and defensive tactics. The review currently is being conducted by a joint subcommittee of corporate chief executives and legal experts who serve on advisory committees to the NYSE Board. In its initial report released in early January, the subcommittee recommended that securities currently listed on the Exchange should not be delisted because of the adoption of charter amendments creating two classes of common stock having disproportionate voting rights, provided that certain conditions are met. With respect to issuers which have not yet applied for listing but wish to adopt such defensive measures, the subcommittee plans to make recommendations at a later date.

Obviously, the desire of issuers to adopt defensive measures has created a highly competitive environment for listings. It has been suggested that this type of environment may cause issuers to choose the market on which their stock will be traded based on the absence of restrictions on defensive tactics rather than on the quality of the markets or the services provided by the SROs.

With respect to market structure, the Division of Market Regulation is reviewing a proposal by the NASD and five securities exchanges to trade options on OTC stocks that qualify as National Market System (NMS) securities. Currently, four securities exchanges participate in the market for standardized options on individual securities, where options are allocated to a particular exchange under a lottery system. At present, only securities listed on exchanges underlie such options.

While options on individual OTC stocks are not currently traded, allowing OTC options to be traded could provide more depth and liquidity to the market for the securities underlying such options. The proposals to trade options on OTC securities, however, raise issues concerning multiple trading of options and competition between markets. In addition, these proposals raise questions about whether last sale reporting for NMS securities is accurate and timely enough to support options trading on such securities.

Also in the options area, on February 13 the Commission will be considering a proposal by the NYSE to trade options on individual stocks. Because the NYSE currently is not a participant in the market for options on individual stocks, this proposal also raises significant issues for the structure of the options markets concerning competition between markets and the NYSE's traditional dominance of the equities market.

In the investment company area, the Division of Investment Management soon will be conducting a comprehensive study of the mutual fund industry and the Commission's regulation of that industry. The Investment Company Act of 1940 established a comprehensive regulatory scheme designed to address many of the abuses in the mutual fund area which existed prior to 1940. While there have been modifications to the 1940 Act over the years, significant changes in the structure of the mutual fund industry warrant a comprehensive review of the industry to determine whether some of the provisions of that Act should be modified.

The Division of Investment Management also recently assumed responsibility for the activities of the Office of Public Utility Regulation. With regard to the regulation of public utility holding companies, the Commission is continuing to urge repeal of the Public Utility Holding Company Act of 1935. The principal purpose of that Act, the dismantlement of multi-tiered holding companies, was achieved over twenty-five years ago, but the Act continues to burden electric and gas utilities, investors, and consumers with redundant regulations. I hope that, within the next year or so, repeal or major amendments to the Act will be accomplished. In the meantime, the Office of Public Utility Regulation will explore possible rulemaking initiatives to reduce some of the regulatory burdens of the 1935 Act while still assuring compliance with the Act.

In the accounting area, the Commission and the Office of the Chief Accountant continue to oversee the accounting profession. The Commission is authorized by statute to prescribe accounting standards for financial statements contained in reports filed with the Commission. In meeting its statutory responsibilities, the Commission historically has looked to the standard-setting bodies designated by the accounting profession, such as the Financial Accounting Standards Board (FASB) and the American Institute of Certified Public Accountants (AICPA), to provide leadership in establishing and improving accounting principles. Over the past year, the Commission has held a series of meetings with the FASB and the AICPA to discuss issues such as the recently completed conceptual framework project, accounting for pensions, and various projects involving the question of when to remove assets and liabilities from the balance sheet (i.e., transfer of receivables with recourse and in substance defeasance).

In addition, the Commission has encouraged the standard-setting bodies to provide more timely guidance on emerging accounting issues, which helps prevent the spread of alternative and, perhaps inappropriate accounting practices. In response, the FASB has expanded the use of staff bulletins and has established an Emerging Issues Task Force to identify problems and provide timely guidance. The Commission will continue to work with the FASB in the hope that this initiative will be successful.

The Commission also has its own accounting related rules and interpretations. These rules and interpretations supplement generally accepted accounting principles (GAAP), as established by the private sector, by addressing those areas that are unique to Commission filings or where GAAP is not explicit. The Commission continually reviews its accounting rules and interpretations to ensure that the requirements remain necessary and cost-effective in today's environment and contribute to the usefulness of financial reporting without imposing unjustified burdens on issuers. In fact, just recently the Commission issued new disclosure requirements for reserves of property/casualty insurance companies, and the staff currently is studying issues involving bank and savings and loan holding companies, off balance sheet financing and quarterly segment disclosures.

Finally, the Commission and the Division of Enforcement continue to devote substantial time and resources to the Commission's enforcement program, which is designed to preserve the integrity, efficiency, and fairness of the securities markets. Much of the Commission's enforcement efforts in recent years have been devoted to accounting fraud -- so-called "cooking the books" or "cute accounting" cases. Audited financial statements are the backbone of the disclosure system under the federal securities laws and if their integrity is undermined because they are inaccurate or distorted, the entire disclosure process is corrupted.

To preserve the integrity of the disclosure system, the Commission maintains an active program to detect, investigate and pursue cases involving deficient audits conducted by independent accountants and the issuance of false financial statements by corporations. Cases in this area have been characterized by elaborate schemes and cover-up attempts and may involve valuation of inventories, assets or liabilities, the remuneration of officers and other related parties, the ability of a corporation to meet its obligations, or the recognition of revenue and expenses.

In order to carry out the program effectively, the Division of Enforcement employs a staff of highly qualified accountants familiar with the various areas of accounting and auditing. A number of injunctive actions and administrative proceedings have been instituted in the area in recent years, which involve complex accounting and auditing questions.

In addition to accounting fraud, the Commission continues to be concerned about insider trading. While insider trading cases receive a lot of publicity, they constitute only about 8% of the enforcement cases brought by the Commission each year. Nonetheless, the Commission views seriously its responsibility to enforce the laws proscribing insider trading. One of the most publicized of the Commission's cases involving insider trading is SEC v. Winans, where Foster Winans, the former author of the Wall Street Journal's "Heard on the Street" column, is alleged to have engaged in insider trading by tipping friends about the content of "Heard on the Street" columns before they were printed. The Commission's action in the Winans case has been stayed pending the outcome of the criminal trial currently being conducted.

To assist the Commission in enforcing the prohibitions against insider trading, late last year Congress passed the Insider Trading Sanctions Act, which permits courts to impose civil fines -- up to three times insider traders' profits (or losses avoided). This should prove to be more of a deterrent to potential violators than prior law, where the Commission was only empowered to seek disgorgement of profits. The Commission filed its first injunctive action seeking a penalty under the Act in November 1984.

In the international area, the Commission continues to be concerned about its ability to reach and prosecute violators of the federal securities laws who reside in areas outside of the Commission's jurisdiction. This has proven to be a particularly serious problem in the area of insider trading, where violators often seek the protection of foreign secrecy or blocking laws. And the increasing internationalization of the securities markets promises to make this an even more pressing problem in the future.

One approach to the problem presented by foreign secrecy laws is the so-called "Waiver by Conduct" proposal that was released for comment by the Commission last summer. That proposal basically would provide that foreign investors waive their right to confidentiality under their own country's secrecy laws simply by trading or selling in the U.S. securities markets. The proposal has been controversial and has evoked approximately sixty comment letters from the public. The staff is currently reviewing those letters.

In closing, I hope that I have been helpful in sensitizing you to areas of current concern to the Commission.