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The Securities Industry and Markets:  
Past, Present and Future

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Ladies and Gentlemen:

It is a pleasure to be with you.

As we approach the yuletide season, Dickens' Christmas Carol and Christmases past, present and future come to mind. Today, I would like to address aspects of the securities industry and markets - past, present and future.

The Past

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."

"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 that I had great confidence in the new economic policies.

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 expectations 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%.

#### The Present

By 1983, the rate of inflation had declined 60%, the prime rate 50%, and our productivity and growth rates had more than doubled. All of which gave impetus in 1982 and '83 to the broadest and strongest stock, bond and new issue markets in history - which have gone on to make new highs this week. After adjusting for inflation, the Dow Jones Industrial Average is up over 45% since 1982.

Also, since 1981 the SEC has increased investor protections and reduced unnecessary paperwork and other expenses that are ultimately borne by investors, by over a billion dollars 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, well over a billion dollars 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.

### Institutional Book-Entry

Expansion of the institutional, electronic book-entry delivery system, in lieu of the physical delivery of securities by institutions, is saving over \$350 million per annum of expenses ultimately borne by investors.

### 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 hundreds of millions of dollars per annum to companies and their shareholders. The small business exemptions are in response to Congressional directives.

Proxy Simplification

Simplification and improvement of proxy statements and prospectuses have reduced their cost and increased their utility to investors. Few individual investors carefully review proxy statements and prospectuses, but they do rely on investment advisory services, brokers and other professionals, who carefully analyze them and supplementary materials.

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. These new instruments have also increased the breadth and liquidity of the securities and other markets.

Insider Trading Sanctions Act

The SEC proposed the Insider Trading Sanctions Act, which was passed last year. 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.

### Intermarket Surveillance

Electronic intermarket stock and options surveillance systems and transaction audit trails, deter market manipulation and insider trading; improve last sale reporting; 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 misperception, the SEC's budget has been increased by over 33% 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 excess has amounted to over \$70 million - and the 1986 excess is expected to exceed \$30 million. The SEC's fees, budget and personnel are of course set by Congress - not by the Commission. And the fees are remitted to the Treasury as received.

Annual Volume Increases

Also since 1981, through automation, paperwork reduction and other staff initiatives, each SEC division has achieved record results, or the highest levels in years, with 2% to 5% less personnel. The annual volume of enforcement actions has been increased by over 35%; corporate filings reviewed, by over 50%; broker-dealer oversight examinations, by over 60%; self-regulatory organization inspections, by over 70%; and investment company and adviser inspections, by over 100%. And the accounting profession has increased tri-annual accounting firm peer reviews, under the SEC's oversight, by over 100%.

Enforcement Actions

Of the 269 enforcement actions brought during the fiscal year ended September 30th, 54 - 20% of the total - were financial disclosure cases. A number were products of the 1982 recession and the 1983 "hot new issue" market. It is during such periods that some companies and executives are tempted to "cook the books". Actions against brokers and other regulated entities amounted to 42% of the cases and insider trading 7%. The balance involved stock manipulation, internal accounting control deficiencies, foreign corrupt practices and delinquent filings of periodic reports.

### Market Efficiency

Efforts to increase the breadth and efficiency of the securities markets, include recent Commission decisions to increase by 85% to 2,500 the number of over-the-counter stocks that are subject to firm quotes and last sale reports; to permit the New York Stock Exchange to trade options; to permit the stock exchanges and over-the-counter dealers to make competitive markets in OTC options; to test side-by-side marketmaking in OTC options and stocks, through a one-year pilot; and to permit each of the stock exchanges to grant unlisted trading privileges in up to 25 over-the-counter stocks. These market structure innovations are being carefully monitored by the self-regulatory organizations and the SEC.

### The Future

As for the future, next month banks that engage in public brokerage activities will be subject to the same SEC rules and regulations as all other securities firms. In response to concerns raised by William Seidman, the Chairman of the FDIC, the Commission will consider this week, a release which sets forth its willingness to grant time extensions and other accommodations to those banks that are in the process of complying.

Also next month, in order to facilitate shareholder communications, brokers will be required to disclose to corporations the identity of their non-objecting shareholders. Legislation is pending to require similar disclosures by the banks.

Important developments in prospect also concern the increasing internationalization of the securities markets; the immobilization of securities certificates; the SEC's electronic disclosure system; and corporate takeovers.

### Internationalization

For over two centuries, the United States has been a prime beneficiary of foreign investments. Last year, we received \$18 billion of net direct foreign investments and during the first nine months of this year, 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 investors and the global economy, but there are problems. To cite just a few, U.S. shareholders of foreign corporations often suffer financial disadvantages when such companies do rights or exchange offerings.

For example, when listed companies in the UK wish to raise additional equity capital, they are required to do so through rights offerings to their existing shareholders. The rights are valuable but the offering materials cannot be sent to U.S. shareholders, unless they are registered here and comply with our regulations. That is also true of exchange offers by foreign companies.

In addition, statutory mergers of foreign companies have been stalled or blocked, because of regulatory problems posed 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 manipulative 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 many 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. Mutually acceptable international surveillance and enforcement practices are also being explored here and abroad.

#### Immobilization of Securities Certificates

In another area, the SEC is also 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 investors, who ultimately bear such costs, 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 corporations, municipalities and other issuers to do their future public offerings of debt securities in the form of single "Global Certificates" - against which investors' interests are recorded by depositories on a book-entry basis. Also, central depository book-entry facilities are needed for mortgage-backed securities and the increasing array of new financial instruments. And 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) are being encouraged to update their statutes on a timely basis. While outmoded state statutes do not prevent the use of global certificate book-entry systems, they do impose unnecessary costs and burdens 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.

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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.

IBM Credit has registered a billion dollars of debt, all or a portion of which may be sold in book-entry form. This would be the first major public offering of conventional corporate securities on a book-entry basis.

GNMA recently announced support for a depository to immobilize billions of dollars of pass-through mortgage certificates. And the U.S. Treasury has announced that next year, it will stop issuing note and bond certificates. All future treasury securities will be issued on an electronic book-entry basis. Freddy Mac and Fannie Mae are also converting to the Treasury's book-entry system for their future offerings.

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

In the United States, 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 & Co., IBM and Dow Jones, Inc. 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 throughout the world on home and business computer screens. Detailed corporate information, will be publicly available in minutes and hours, instead of days and weeks.

Participants in the pilot include AT&T, General Motors, IBM, Exxon and other large and small companies, and the California, Georgia and Wisconsin state securities commissions. Over 180 participants have filed electronically over 2,000 documents. The pilot is being steadily upgraded and expanded. It is being doubled in size 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 by the fall of 1986 and to phase-in the 11,000 publicly-owned companies over the three succeeding years. The Commission plans to finance the system with appropriated funds and user fees.

### Corporate Takeovers

I would like to conclude with some brief 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 this year, quantifies the benefits to shareholders. It indicates that target companies' shareholders have received an average premium of 47% over the prior market price of their shares and that the bidders' shares have risen an average of 4% net-of-the-market. 4/ The 47% average premium amounts to about \$39 billion.

In any case, today I would like to focus on some of the legislative and regulatory issues currently pending before Congress and the SEC.

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

Corporate responses to the threat of takeovers include antitakeover charter and by-law amendments, supermajority vote requirements, fair price provisions, recapitalizations, staggered boards and "poison pills". 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 the companies' 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 some boards are unilaterally adopting poison pills, which do not require shareholder approval.

Poison pills may consist of preferred shares, warrants or rights, that are distributed as dividends to shareholders - whether they want them or not. In the event of a takeover threat, they typically permit the holders to acquire certain of the company's assets or the shares of an unfriendly bidder at low prices; or they may be exchangeable for debt securities. In each case, they are intended to make target companies prohibitively expensive to acquire on an unfriendly basis.

About 30 companies' boards have adopted poison pills, including Colgate Palmolive, Crown Zellerbach, Dart & Kraft, General Host, McDonald's, Owens-Illinois, RCA and Revlon. However, poison pills did not prevent Sir 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. Two weeks ago the Delaware Supreme Court upheld the Household International poison pill. As a consequence, many more corporate boards are expected to adopt poison pills in the near future.

In recent months, there have been a number of other important court decisions and legislative proposals, concerning one-share, one-vote requirements; exclusionary tender offers; the 13D 10-day window; open market and privately negotiated purchases; greenmail; golden parachutes; two-tier tender offers; and so-called "junk bonds".

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.

The Commission is re-reviewing the foregoing and other takeover issues, and expects to report its conclusions to Congress next month.

In response to exclusionary tender offers, the Commission has recently solicited comments on an "All holders, best price" rule that would apply to both issuer and third party tender offers.

During the past year, the Commission has proposed legislation to close the 13D 10-day window, but has generally opposed legislation that would tip the balance in favor of bidders or targets. The Commission has relied instead on its regulatory authority, the marketplace, existing laws and the courts. To date, reliance on the foregoing and on shareholders to protect their own interests through their voting and other rights, has generally worked well.

And from the corporate point of view, a company's 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' resources on a sound basis, for the benefit of their shareholders - and the vast majority are doing so.

### Conclusion

In conclusion, America has today by far the best securities markets the world has ever known - the broadest, the most active and efficient, and the fairest - due primarily to the extraordinary depth and breadth of our economy and the outstanding job being done by the business and financial community - but the markets are not perfect and they are evolving rapidly and facing increasing competition from abroad.

Effective investor protections and fair and orderly markets are in the interest of all concerned. Through the ongoing efforts of the self-regulatory organizations, the state securities commissions and the SEC, with the cooperation and support of the business and financial community, tomorrow's markets will be even better than today's.

Thank you.

I will be pleased to amplify any of the topics mentioned and I would appreciate your comments and suggestions.