



REMARKS OF
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CHALLENGES AND OPPORTUNITIES
FOR THE 1990s

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

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I. Introduction

Thank you, Joe, for the overly gracious introduction. You know that it is often said that the more well-known a person is, the shorter the introduction. As you can see from Joe Hardiman's introduction, I still have a long way to go. As Joe mentioned, before I joined the SEC, I spent 14 years with Alex Brown & Sons, and he was involved in hiring and training me. It's interesting to note that at the time, Joe was my compliance officer. My, how things change

All of us in this room are all part of a proud tradition. Since the NASD was founded in 1939, not long after the creation of the SEC, both the association and its members have transformed the OTC market into the second busiest market in the world, as measured in the first quarter of this year. You have shown that screen-based markets are fair and efficient markets that provide investors attractive investment opportunities.

Having now sat on both sides of the table, I have a unique appreciation for what makes the self-regulatory system work so well: it is the commitment of the self-regulatory organizations and their membership to the dual role of market operator and market overseer. You have demonstrated great vision by pro-actively responding to competitive challenges. Witness the customer-driven buttons I see all around. You also have shown great integrity in your role as the first line of defense for investor protection. From my perspective as a regulator and a former member of a regulated entity, I believe that you have worn your self-regulatory hat well and become the model for many others around the globe.

As I understand it, my nomination to the SEC grew out of a desire at the White House to have someone with direct market experience, preferably a non-lawyer, on the Commission. At the end of the day, when people look back on my tenure at the SEC, I hope they will identify me with two themes: First, remaining vigilant against unnecessary burdens on the capital markets; and second, preparing for the 21st century by addressing international trends, including ever-

increasing cross-border equity flows and the proliferation of cross-border derivative instruments. Today I would like to spend a little time describing how I believe the SEC and the NASD together can advance these causes.

II. Reducing Burdens

No one intentionally sets out to overburden markets.

Nevertheless, the SEC cannot, unlike some market participants, see into the future and predict every consequence of the proposals it adopts. Moreover, environments change. Today we operate in a global market where many market activities are easily conducted in off-shore locations. Thus, the SEC is well-served by periodically re-examining whether the requirements it imposes have the unintended effect of shifting trading off-shore and not serving the regulatory purposes intended. There are a few recent SEC initiatives that highlight this Commission's willingness to engage in such soul-searching.

One is the SEC's Small Business Initiative, which we announced in March. The Initiative is a set of proposals designed to facilitate capital raising among small companies. In response to the needs of small companies, Chairman Breeden directed the Divisions of the SEC to review whether the statutes and rules they administer impose undue burdens on small companies. As I stated to Senator Riegle during my confirmation hearings, it's not clear to me that anyone had the needs of entrepreneurs in mind when the securities laws were written in the early 1930s.

The result of the review was the Small Business Initiative, which was included in the Commission's report to the President on regulatory reform initiatives that was announced at a Rose Garden ceremony earlier this month. I believe that these proposals could reduce by billions of dollars in the aggregate the regulatory costs faced by small companies seeking funding.

I suspect that many of you may be interested in the proposal, because the OTC market has traditionally been the market of choice for

young and start-up companies. Many start-up companies have enjoyed phenomenal success on NASDAQ -- we are all familiar with MCI, Apple, and hundreds of others.

Some have charged the SEC with election year politics in the timing of the Small Business Initiative. In fact, during my confirmation hearings Senator Riegle made this suggestion directly to me. I responded that the reason for my interest in facilitating capital raising for small companies at this time was the fact that 1991 saw a disturbing shortage of capital for this sector, particularly, from bank lending and venture capital sources. Fortunately, small companies had access to the equity markets last year, as Joe clearly demonstrated with his statistics this morning, or things would have been considerably worse. Because 1991 demonstrated that the equity markets are so vital to small companies and thus to our economy, now is the time to make them even more accessible -- election year or not.

I also said that it is important to note that small companies sometimes become big companies. A classic example is Microsoft. A

little over 10 years ago, it did not exist; over 5 years ago, it was not public. Now it has over \$22 billion in market capitalization, employs 10,000 and leads the world in its industry. What we are trying to do is to help other companies achieve the same success.

The Division of Investment Management also is engaging in a comprehensive examination of the program it administers. As you will read tomorrow, Investment Management issued a comprehensive report today, detailing proposals to make the law governing pooled investment vehicles more flexible and to reduce regulatory costs, without sacrificing investor protection. Some of the specific proposals are geared toward capping costs, such as 12b-1 fees, allowing new kinds of funds with different redemption features, and making it easier to buy funds advertised in the newspapers.

Market Regulation has also begun a wide-ranging study that it has aptly christened "Market 2000". The study will be carried out under the direction of Bill Heyman, Director of the Division of Market

Regulation, who, as many of you know, spent most of the Eighties as an active participant in the markets.

The last comprehensive study of the securities markets was conducted 20 years ago. Since that time the equity markets have undergone dramatic changes. For example, we have seen phenomenal growth in the institutional market. And institutional investors, with their increasing market clout, have spurred the development of off-exchange trading systems as a means for reducing their trading costs.

Additionally, the explosive growth in the derivative markets has profoundly altered the dynamics of the markets. Among other things, the derivative markets provide an attractive alternative to investing in the underlying equities and thus have facilitated large investors' adoption of indexation strategies. Some also argue that the derivative markets can have a significant impact on the liquidity of the equity markets, particularly in times of market stress. In addition, the recent proliferation of customized OTC derivative products may introduce new

degrees of risk to the markets that are neither entirely understood nor effectively quantified.

Market 2000 provides a good opportunity to study the effects of these changes on the markets and how markets and regulators should respond to them.

For the most part, the Commission has reacted to these developments incrementally, responding to individual proposals from the markets as they were submitted. Thus, the time seems to right to try, in a systematic way, to come to some conclusions on the appropriate regulatory structure for the markets for the 21st century. We hope to publish a concept release outlining the study for comment next month and we expect the study to take a year after that to complete.

You are hearing me talk a lot about reducing unnecessary burdens. But we cannot forget that our first and foremost responsibility is the protection of investors. It goes without saying that

the greater the perception that the markets are fair, the more liquid the markets will be. A look across the Pacific gives a clear indication of that.

Nevertheless, there is a delicate balance to be achieved between the protection of investors and overly burdening market mechanisms. It is fairly easy to overregulate in the name of investor protection, but that is a temptation we must resist. Not only do we as regulators and self-regulators have to heed this warning, but Congress should also. The securities laws have, on balance, worked very well in this country, which is demonstrated by the phenomenal success of our markets. In contrast, you have only to look at the tax code to see the result of frequent Congressional tinkering.

We face several issues today where the re-emergence of heavy-handed government is a real threat once again. In particular, I would like to briefly mention the current debate on abusive practices in limited partnership roll-up transactions, as well the recent heated discussions on executive compensation.

Over the last few years there has been a significant amount of attention paid to limited partnership roll-up transactions. The attention has been justified -- investors involved in roll-ups have not always been treated fairly.

The SEC responded by adopting a number of proposals that are designed to assure investors that they will have adequate information to weigh the merits of a particular roll-up transaction. In addition, the NASD has adopted rules prohibiting brokers from accepting compensation based solely on their solicitation of "yes" votes.

Despite these fairly comprehensive measures, there are several bills now pending, including one that is being marked-up in the Senate Banking Committee today, that would go even further. In my view, they are unnecessary. Simply put, I believe that there is no demonstrated need for additional action at this time. In addition, I believe that some of the provisions of the legislation may conflict with state law. My greatest concern is with the federal appraisal right that

has been proposed. Such a provision may potentially intrude on what has traditionally been governed by state law. It would also drastically alter the rights of partners long after they have agreed on them and invested based on them.

I am also concerned about the current debate on executive compensation. The whole issue has been the subject of fierce public debate recently. It has generally been a healthy debate, once you get beyond the sensationalist headlines. But it is also proving to be a great populist issue in an election year. There are two bills currently pending: one would limit executive pay to 25 times that of the lowest-paid employee and the other would require all public companies to use confidential voting and independent tabulation of votes. In addition, there is also a possibility of a legislative proposal on stock option accounting this session.

I believe that the appropriate response to these issues is for the SEC to assure the availability of clear and understandable disclosure, so that the issue can be decided in the marketplace and shareholders can

vote in an informed manner. Last year the SEC published several proposals on executive compensation and will issue revised proposals shortly. In addition, the SEC's Office of Chief Accountant is conducting a study of the issue of stock option accounting, which will examine the issues involved in valuing these options.

Our goal is to highlight and simplify disclosures on compensation of the highest paid executive officers. The most important point I can make, however, is that we are searching for a marketplace solution: this SEC does not believe that the government should be in the business of setting compensation levels.

A few weeks ago, Reebok announced that 27% of the voting shares voted in favor of an independent compensation committee to review senior executive compensation. There have been a number of other annual meetings in the last few weeks where executive compensation proposals have garnered percentages in the mid-teens. To me this indicates that the marketplace is working and I am sure that we will see even more evidence of that next year.

III. Internationalization of the Markets

As I mentioned at the beginning of my remarks, the second theme that I hope to press at the SEC is that a proactive response is necessary to the internationalization of the markets. My 14 years of experience in the markets and my experience on the board of the Overseas Private Investment Corporation and the SEC's Emerging Markets Advisory Committee have convinced me that today capital clearly knows no boundaries. The evidence of that is overwhelming: from 1984 to 1990, gross cross-border equity flows have increased from about \$300 billion per year to about \$1.7 trillion per year. We have also recently seen huge multinational offerings become a reality. Prime examples are the Telefonos de Mexico offerings, including the one today, the Attwoods PLC worldwide offering for \$142 million last winter, and the New Zealand Telecom offering for \$189 million in mid-1991.

It is currently estimated that one out of every seven equity trades worldwide involves a foreign counterparty. In addition, our research

shows that, on average, U.S. investors' gross daily purchases and sales of foreign securities are approximately \$4 billion, an increase of about 33% in the last two years. While some of this demand is satisfied in the home country, a significant percentage is satisfied in foreign markets. To illustrate, I can point to the fact that roughly 10% of all trading in U.S. equities takes place outside the United States;¹ and that the volume of foreign shares traded on the NYSE and on NASDAQ is approximately 6% to 7% of total share volume.

In addition, we have seen dramatic growth in recent years in the international OTC derivative market. This is a complicated market and deserves our attention. As New York Fed President Gerald Corrigan stated before the New York State Bankers Association in January, "[t]he growth and complexity of off-balance sheet activities and the nature of the credit, price and settlement risk they entail should give us all cause for concern"²

¹ Breeden, Remarks at the London School of Economics, London, England (November 8, 1991).

² Corrigan, Remarks before the New York State Bankers Association, New York (January 30, 1992).

The global marketplace provides both opportunities and challenges for all participants. Internationalization presents new investment opportunities and untapped markets. As regulators, we need to be creative and flexible in addressing the issues globalization presents.

I have to commend the markets for showing creativity in proposing a number of new trading mechanisms designed to attract international interest. Likewise, I believe that the SEC has to be credited for showing flexibility in accommodating the various proposals.

In my view, there are two primary goals that we should be aiming for: (1) repatriating order flow in U.S. securities that we have lost to foreign markets and (2) finding a way to satisfy on-shore the voracious demand for foreign securities. The challenge, of course, is to achieve these goals without sacrificing the key attributes of our regulatory system that have made the U.S. markets the pre-eminent markets in the world.

In recent years, the NASD and the exchanges have searched for ways to attract order flow in U.S. securities back to the U.S. markets. As you know, the SEC has approved proposals from the NASD to create NASDAQ International and from the New York Stock Exchange ("NYSE") to create its after-hours trading sessions. Although both initiatives have not yet reached their full potential, they represent creative responses to the need to facilitate some form of off-hours trading in the United States. Because these proposals offered the prospect of returning some order flow in U.S. securities to U.S. markets and oversight, the SEC granted the NASD and the NYSE certain trade reporting exemptions; although it did so somewhat reluctantly.

Another challenge is finding a way to satisfy the demand for foreign investments in the United States. Not only will this inure to the benefit of the markets, but it will also allow U.S. investors to continue to enjoy the protections offered by our regulatory system.

The SEC has taken a number of steps that have been carefully designed to meet the demand for foreign investments by U.S. institutional and retail investors. The SEC has, for example, adopted several proposals intended to ease foreign issuers' access to U.S. markets. Among them are the SEC's adoption of Rule 144A and the Multi-Jurisdictional Disclosure System with Canada.

Rule 144A was partly conceived as a way of attracting foreign issuers to the U.S. markets, on the theory that foreign companies might find a liquid private placement market an attractive way to access U.S. capital. Now that the SEC has had a couple of years' experience with the rule, we are considering whether it is appropriate to expand the definition of who qualifies as a Qualified Institutional Buyer, or QIB, in SEC parlance. Among other things, we are looking into how to handle insurance company separate accounts and bank collective trust funds and master trusts. Of course, increasing the number of eligible participants would result in greater liquidity in this market.

The next step is to channel more of the trading in these securities toward a trading system. The NASD should be applauded for recognizing the potential that Rule 144A presents in creating the PORTALMarket.

To encourage the further development of U.S. markets in certain Canadian securities, the SEC has adopted the multi-jurisdictional disclosure system. The initiative allows certain Canadian issuers to register securities and to meet continuous reporting obligations using documents prepared largely in accordance with Canadian requirements. The SEC hopes to expand the MJDS to include other countries in the future.

The common element in these two proposals is that they all flexibly apply U.S. regulatory standards without sacrificing the core investor protections that make our markets strong. I firmly believe that whatever further steps we take to address the internationalization of the markets, we have to show the same sensitivity.

IV. Conclusion

Over \$40 trillion in securities transactions take place in the United States annually and, by any measure, fraud in our markets is substantially less than 1% of annual volume. Our markets and regulatory system are the model for the world. And they will continue to be as long as we respond to the evolving needs of investors and fulfill our mandate to assure the protection of investors and the maintenance of fair and efficient markets.

No matter what form the markets take in the future, whether it is 24-hour trading systems or otherwise, U.S. markets will continue to lead the way because of the resourcefulness and innovation you, as market participants and regulators, have always exhibited. The integrity of our markets will also be assured through the coordinated efforts of the self-regulatory organizations and the SEC. I look forward to being a part of those efforts. Thank you.