NEWS

SECURITIES AND
EXCHANGE COMMISSION
Washington, D. C. 20549
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FOR RELEASE: 10:00 A.M., THURSDAY, NOVEMBER 29, 1979

THE SECURITIES INDUSTRY ENTERING THE EIGHTIES: AN ECONOMIC OVERVIEW

An Address by Harold M. Williams, Chairman
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The Securities Industry Association
1979 Annual Convention
Boca Raton, Florida

November 29, 1979

I welcome the opportunity to speak to the Securities Industry Association convention for the third time in my capacity as Chairman of the Securities and Exchange Commission. I regard the invitation to address you as one of the most important events on my speaking calendar since it affords me the opportunity to exchange views with the leaders of an industry which is key to our Nation's future.

This year, I would like to share with you some thoughts about the economic posture of your industry. In my two previous appearances before you, I devoted most of my time at the podium to an analysis of the evolution of the National Market System. This year, I have already had several opportunities to speak to industry groups, a number of personal meetings and a lengthy appearance recently before our House Oversight Committees which was broadly reported. Tomorrow in New York City, I will address the matter again at the ALI/ABA Broker-Dealer Conference. Accordingly, while market structure continues to be of critical importance, I will focus today on still broader issues concerning the securities industry's future direction and reserve my comments on the National Market System for tomorrow.

At the outset, let me explain why I would characterize developments which touch on the industry's economic health as broader than questions concerning the structure of its markets. The capital formation and allocation process, in which the securities industry plays a vital role, provides the fuel for our economic system -- the most successful in the history of the world. If the securities industry itself is not healthy and vital, then the vigor of the private enterprise system which it sustains and supports will be jeopardized. That system, in turn, underpins the economic ability of our society to aspire to national goals as important and diverse as full employment, energy independence and an improving quality of life. Thus, the activities of the securities industry in maintaining investor confidence in the fairness and liquidity of our markets and in marshalling capital in order that business may discharge its role in accomplishing these goals are at the heart of our national fabric. That is a fact of which none of us can afford to lose sight in our roles as regulators, businessmen or securities professionals.

It is important for several very specific reasons that the Commission have an appreciation for the basic economics and operating conditions of the securities industry. First, if industrywide problems were to develop which seemed to threaten the market mechanism or the investing public, the Commission would need to consider whether a regulatory response was appropriate and what shape that response might take. Secondly, in the rulemaking process, it is vital that the Commission be able to make knowledgeable judgments as to the implications of current or proposed regulations on the industry or on its various segments. Thirdly, the Commission has been increasingly invited to participate in broad public policy discussions and to comment on the likely impacts of new legislation on the securities industry, on issuers and on investors. All of these aspects of Commission responsibilities demand that the Commission be well-enformed about the industry.

Similarly, firms in the securities industry need to understand the consequences to their own health and future, and to the industry's of the decisions which they make. It is important that we all fully appreciate the implications of developments in the industry for its continued ability to perform its most basic functions as securities underwriter, distributor and intermediary, and to continue to attract and retain the human talent and capital necessary to serve the private capital needs of our economy. And, in that context, I am troubled over the Commission's and the industry's apparently limited understanding of the economic dimensions of the securities business. I can assure you that the Commission is committed to the development of a broader understanding of these matters. My remarks today are intended to raise issues, provoke discussion and encourage the industry in its own efforts to plan ahead and better assess its role in the environment of the 1980s.

Against that background, I would like first to comment on the recent financial record of the securities industry. Next, I will discuss several emerging developments which may indicate longer-term trends significant to the industry and to the Commission. Finally, I want to describe how the Commission -- largely through its Directorate of Economic and Policy Research -- is enhancing its analytical capabilities in order to respond effectively to its regulatory responsibilities in an increasingly complex setting.

Our commitment to enhance economic analysis does not, however, presage a movement by the commission towards economic regulation. The record is replete with the failures of economic regulation by government. We are trying to gain a better understanding of the industry, not to dictate its shape or function.

Recent Financial Experience of the Industry

The Staff Report on the Securities Industry in 1978, which was publicly released earlier this year, and is now an annual product of the Commission's staff, shows that last year was fairly good for the securities industry as a whole. While 1978 results are not news, they provide a valuable base line for our discussion. In comparison with 1977, an admittedly mediocre year, total revenues rose by about 31percent to $8.8 billion, and expenses rose at a somewhat slower pace of 29 percent to $8.1 billion. Reflecting these developments, profit margins expanded and the industry's annual pretax return on capital advanced to 16.5 percent. But we have no standard of what constitutes a return adequate to attract or retain capital long term against which to compare this performance. In fact, our knowledge of the basic operating conditions and our appreciation of the longer term prospects for the industry are not adequate to shed much light on questions such as this. For the Commission and the securities industry to be able to confront effectively the demands of the coming decade, our understanding of these dimensions of the economics of the industry must be improved.

On balance, market conditions volume rose substantially in 1978, as indicated by the rise of over 35 percent in exchange share trading and an increase of about 50 percent in over-the-counter activity. This positive factor was somewhat offset by generally rising interest rates and a falloff in total municipal and total municipal and corporate underwritings. Industry profitability appeared to correlate more with product and customer mix than with any other dimensions One bright spot in the underwriting picture was the increase in initial public offerings of common stock coming to market in the second half of the year. As noted by Ed O'Brien in a recent article 1/, these offerings were probably encouraged, at least in part, by the liberalization of the tax treatment of capital gains enacted 'y the Congress last year. This reform, which I had the opportunity to support in Congressional testimony, is intended to promote capital formation. Its adoption, plus current discussions of accelerated depreciation and the value-added tax, may signal a greater national readiness to take action to stimulate saving, investment and risk taking. While this possibility is encouraging, it is not assured, and its realization will require a continuing effort on the part of those of us concerned about enhancing capital investment and rewarding risk taking.

1/ Edward I. O Brien, "Reduction of Tax on Capital Gains Spurs Investment," Wall Street Journal, October 31, 1979, p. 24, column 3. Also noted are the market performance of the shares of relatively newer firms and the increase in venture capital formation activities.

From the data we currently have available, 1979 began as a better financial year for the industry than 1978. Returns for the first half of 1979 indicate that a slackening in secondary market volume was compensated for with increases in trading profits and an expansion of margin activity. It was certainly a profitable period for mergers, acquisitions and arbitrage. The pretax profit margin for NYSE firms doing a public business stood at a little over 10 percent in the first half of 1979, and while this was below the peak 1978 rates of over 13 percent in the second and third quarters of that year, it still represented an improvement over the profit margin experience of 1978 when taken as a whole.

In the second quarter alone, the rise in business activity led to an increase of about $14 billion in industry assets, an increase equal to some 25 percent of the total at the end of the first quarter. Increases in customer receivables, securities purchased under resale agreements, and most importantly, an increase in the industry's long positions in securities and commodities, accounted for nearly all of the rise. Unsurprisingly, these additional assets were largely funded through the assumption of greater liabilities. While industry equity grew by approximately $150 million, bank loans and securities sold under repurchase agreements rose by nearly $9.5 billion. These developments combined to produce, as the industry entered the third quarter of this year, a debt-to-equity ratio of 17.4, up from 14.3 in the first quarter, and the highest since 1965, when this information was first collected by the Commission. Again, as with the return on equity, the implications of increasing leverage and the related risk are not well understood and we have no standards or rules of thumb to measure them against.

Even though October saw a record set for a single day's and week's volume, the industry has been, understandably, more focused on the Federal Reserve Board's latest policy initiatives and their implications for the capital markets. Sharp declines in fixed income and equity securities' prices have led to serious trading and underwriting losses, the magnitude of which have not yet been quantified. However, in my view, there have also been encouraging developments. First, the sharp increases in market trading activity appear to have been handled with little difficulty, a feat which could not have been achieved five years ago. This is a tribute to back offices, exchanges, clearing operations and to facilities which provided current market information independent of the tape. Secondly, as analysts of economic policy, members of the securities industry have an obligation to support those policies which they honestly view to be in the Nation's long-term interest. Despite the volatility of the markets, a volatility which may continue as this new phase of anti-inflation policy is vigorously pursued, and despite the sizable trading and underwriting losses incurred, the industry generally has been supportive of the Federal Reserve Board's actions. To the extent that the industry can help raise the public awareness of the sources of, and present danger from, ever-increasing rates of inflation, then it will be serving in the public's interest, as well as its own.

These short-run developments -- whether the current state of the securities markets or the recent financial record of the securities industry -- are of great importance. However, just as we cannot lose sight of the possible longer term implications of the success or failure of anti-inflation policies, so we must strive to identify other longer-term trends which may determine the shape and place of the securities industry in the coming decade.

Trends in The Securities Industry

Several kinds of developments hold the potential for importantly affecting the securities industry in the coming years. One of these, the so-called Papilsky issue, has already received a good deal of attention and will continue to be actively discussed. As it is currently the subject of a Commission proceeding, I am not free to discuss it this morning. I would, however, like to focus attention on a number of other developments which may have an important influence on the securities industry in the '80s.

There are a number of currents and themes running through the affairs of the securities industry which cannot yet be fully analyzed, but which seem both significant and potentially troubling. I include the increasing evidence suggesting that the industry is at once becoming increasingly concentrated and yet less committed to the core securities services it has historically provided. Another is the growing competition between securities firms and other financial service firms for each others' traditional product lines and clients.

Concentration

One clear trend revealed in recent history is that the securities industry has become more concentrated. By concentration I mean that a greater and greater share of the industry's equity and revenues are found in a relatively small number of large firms. In 1972, approximately 30 percent of gross revenues and 35 percent of the industry's equity capital In contrast, by 1978 the top ten firms in terms of revenues accounted for over 45 percent of total industry revenues. At the same time, the top ten firms held nearly 50% of the industry's equity capital. Your Research Department points out the trend in concentration among the next fifteen firms is even stronger. I do not mean to imply that we have indications that the industry is anything but highly competitive. First, the identity and the relative positions of the top 10 firms across various measures of concentration can change fairly dramatically over time. Secondly, the large adjustment in industry pricing to negotiated rates after the end of fixed commissions is not supportive of any suspicions of effective anti-competitive practices within the industry. Still, the creeping trend towards concentration persists and at some point must become troubling.

The tendency towards concentration can be accounted for in two ways. First, the internal growth of some of the larger firms may be faster than that for the industry as a whole. Secondly, mergers and consolidations among existing firms contribute to the trend. While an appreciation for these factors may help us to describe the tendency, it does not identify the underlying causes of increased concentration.

Is the unfixing of commissions responsible for the trend in concentration? Some would argue that it is, but as is discussed in the most recent Staff Report, an attempt to statistically separate such an influence leads our staff to conclude that the trend towards concentration seems to have started well before the introduction of fully negotiated rates and appears to have continued since. And, as was evident to me during my recent trip to the City of London, fixed commissions do not guarantee immunity from a strong trend towards securities industry concentration.

Did the unfixing of commissions provide any other, more subtle, encouragement for the formation of relatively larger firms which the analysis to date has not uncovered? Perhaps. But, in the same Staff Report, further analysis of firm profitability by size provided no such clues. In addition, the SIA Research Department recently concluded from its own analysis that "... firm size is not a key determinant of performance." 2/

Has firm fixed overhead become so large that it can handle significant increases in volume incrementally? Perhaps. But the ability to break out fixed costs from the data we have is limited. Has the generally unsettled and highly unpredictable economic environment of the 1970s contributed to concentration? Such an environment, alone, may provide an incentive for firms to seek the shelter of increased size and a "full line" of services. Yet, the logic does not appear compelling.

2/ Jeffrey M. Schaefer and Timothy Y. Smith," Economies of Scale: An Unsettled Issue," Securities Industry Trends, September 28, 1979, p. 3.

Might speculation about the ultimate structure of the National Market System have promoted concentration? The perception which places a high value on future access to order flow and market making abilities also assumes that full line firms with extensive retail distribution systems will be best positioned to flourish in the new environment. The wisdom of this perception is far from clear.

And it is not clear, moreover, that combinations of existing firms add anything to the industry's real capacity to serve issuers and investors. Indeed, to the contrary, it seems that the net effect of consolidations is to reduce capacity and capability. All too frequently, the consolidated firm assumes underwriting positions and market making risks smaller than those previously taken by the aggregate of the preconsolidated parts. This is one case where two plus two frequently equals three, resulting in a real reduction in the industry's capacity to underwrite, to distribute and to provide intermediation in the secondary markets. And from the capital allocation standpoint, who picks up the slack in underwriting, market making and research that the absorbed regional firms provided for smaller regional issuers?

Finally, if these considerations do not completely account for growing concentration, could there be something else?

Are there constraints or privileges within the entire regulatory scheme for securities firms, their customers and their financial services competitors which provide a yet-unmeasured bias toward bigness? If government intervention into the marketplace, designed for the protection of investors, somehow effectively penalizes the small, or perhaps the unusual, firm, then such regulations have the counterproductive potential to actually limit investor choices. It may be quite difficult to describe, much less precisely quantify, the differing impact of regulatory policies on various types of firms. Traditionally, however, the diversity and pluralism of the securities industry have contributed importantly to its ability to be responsive and flexible in meeting the changing needs of our capital markets. Thus, trends in concentration raise questions about the possibility of an unintended and undesired impact of policy.

Diversification

In a similar vein, the growing reliance on relatively novel sources of revenue raises questions as to the causes and implications of the industry's increasing diversification.

The revenue producing activities pursued by securities firms have become increasingly more diversified. By this diversification I do not mean a new, and perhaps more even, balance among the core securities markets services provided by the industry; a greater reliance on market making, for example, relative to agency commissions or underwriting income. Rather, I note a clear movement of industry emphasis away from these activities as a group and into less traditional product lines. As recently as 1976, nearly 80 percent of the industry's revenues came from buying, selling or owning securities. These revenues were in the form of commissions, trading and investment gains, and underwriting income. In 1978, the reliance on these activities fell to just under 70 percent. The percentage would have been lower if subsidiaries not included in FOCUS reports were added. While the magnitude of this shift is not startling, even though it occurred over only a two-year period, I am personally concerned that this trend in diversification is a portent of things to come. While textbook after textbook cites diversification as a theoretical method of reducing risks and the impact of a cyclical business, the acquisition or start-up of unfamiliar product lines may place unexpected strains on management systems and expertise. Further, the casebooks are replete with unsuccessful efforts to achieve the theoretical benefits of diversification -- including unsuccessful efforts of financial companies to become full line "financial services" institutions and of companies to convert their sales organizations in to "distribution systems" capable of distributing many different products with equal competence.

Finally, it is conceivable that for this particular industry at this particular time, diversification itself carries with it some unique risks. On the premise that securities are sold, not bought, and that the enormous amount of pent-up purchasing potential at some point will again be attracted to equities, those who have directed their efforts away from core securities operations, who have not focused on their capacities to underwrite, to distribute and to serve the secondary markets, may find themselves left at the gate just when those services are most needed and most richly rewarded.

Secondly, if the industry's growing diversification signals a retrenchment from its traditional pursuits, then it may foretell a reduction in the industry's overall capacity to deal with extended periods of high market activity or a significantly higher volume of underwriting in an orderly fashion.

While the industry now appears ready to handle the levels of market activity which caused chaos a decade ago, it is not now possible to determine the scope of future challenges. For example, in my judgment, the New York Stock Exchange must develop the near-term capability to handle 150 million share days.

The industry's ability to handle anticipatable levels of market activity and achieve the productivity gains which the industry must produce in the coming decade will come only through a basic modernization of its infrastructure. The tendency has been to place all such considerations of technological advancement under the umbrella od the National Market System. In fact, the most critical tests of the industry's ingenuity, innovation and capital may derive not from the evolution of the National Market System itself, but from fundamental demands to service the marketplace. Much of what needs to be done in order to be prepared to deal with increased volume -- in terms of back office, execution and settlement -- must occur regardless of the National Market System. The days of people scurrying around with pieces of paper are numbered, and a mere addition of bodies and shifting of production and back office talent among firms will prove to be an ineffective long run response to the capacity needs of the industry as a whole. Diversification, with its ever-higher allocation of capital and expertise to pursuits only remotely related to core securities operations, at the very least, reduces the industry's capacity and flexibility to cope with, and to plan for, tomorrow's conditions in the markets.

Finally, to the extent that the industry dilutes its commitment of capital and entrepreneurial skills to its more traditional product lines, it may encourage the perception that clients and markets are not being served as well as they might. If a consensus were to develop that diversification symbolized a reduction in the industry's long-term ability and commitment to service fully the needs of issuers and investors, then it would not be surprising to find that the industry will attract the interest of potential new classes of competitors. The appropriateness of this new competition is already being vigorously debated.

Competition Among Financial Sectors

Not so very long ago, it would have been a fairly easy task to match up a list of financial products, services or clients with the appropriate type of financial services firm. An individual selling his present home and buying a new one, for example, might contract with a local real estate broker for selling services, approach a savings and loan for a mortgage on the new property, and direct a broker to purchase securities if any cash were generated in the transactions. Of course, each transaction would be accompanied by a check drawn against a commercial bank. Today, an individual looking for the same mix of financial services could contact a real estate broker affiliated with a broker-dealer and investigate the possibility of obtaining a mortgage at a commercial bank. Short-term funds associated with the sale of the home could be invested in a money market certificate at a savings and loan, and the balance in a money market fund drawn against to pay for these transactions.

This blurring of the lines between customers and institutions extends to variously named products themselves. For a great number of financial services or products a close, if not a perfect, substitute is provided by more than one type of financial concern, at least for the largest members of the client base. As you know, the propriety of some of these forms of competition is being actively questioned at the same time that the current boundaries of accepted competition in other fields are being challenged.

It seems to be generally accepted that society, as a whole, benefits from a high degree of competition. Competition promotes the most efficient use of our human skills, as well as our capital and other material resources. However, since government regulation of our economic activity is already complex and pervasive, it is often difficult to discern the net effect of policy itself on various sets of potential competitors. If regulation were to confer to one set of firms a competitive edge, then we have only the appearance of open competition.

The rather awesome task that remains for the regulators and the regulated is to identify the inequalities that arise from policies and attempt to measure their current or prospective effects. Each analysis must also make a judgment as to whether equal, though not necessarily identical, regulation can be applied across types of financial services firms without compromising such basic policy goals as the protection of investors and the maintenance of the integrity of our financial system. While these kinds of questions are exceedingly difficult to answer with much confidence, I am fairly sure that the frequency and urgency with which they are asked are unlikely to abate.

More and more, the regulator is asked to leave the comparatively narrow and familiar scope of a single industry and join in more expansive public policy debates. A recent example of this phenomenon was the Commission's participation in Congressional hearings on several proposed amendments to the Glass-Steagall Act. The proposals included one to permit commercial banks to underwrite most forms of municipal revenue bonds. Our involvement in that process was intended to point out the possible inequalities in the respective regulatory schemes for securities firms and banks. In addition, we added to the factual basis for the discussion with the report prepared by the Commission's staff on the impact of bank participation in municipal revenue bond underwriting on the revenues of securities firms, and more particularly, those of smaller broker-dealers. I believe our contribution was useful to the Congress. It is only one example of the growing demands being placed on the Commission's analytical abilities. It is, however, a representative demonstration of our determination to take the steps necessary to meet these responsibilities.

I anticipate that many of the forthcoming requests for the Commission's analysis of regulatory policies will include questions concerning the activities of commercial banks in securities-related fields, and perhaps, the activities of securities firms in areas which resemble traditional banking pursuits. At present, it is virtually impossible to understand the implications of specific issues without an appreciation for the overall relationship between banks, securities firms and their respective regulatory settings. Both securities firms and commercial banks are too essential to the successful interplay of our financial and capital markets for any proposed changes in their relationship to be considered other than in the context of a searching reappraisal of the Glass-Steagall Act and the other laws, regulations and policies which mark the boundaries between commercial banking and the securities industry.

Internationalization of the Markets

Another issue which must take on major significance in the 80's is the increasing internationalization of markets, issuers and investors. The reallocation of capital around the world resulting from growth of non-U.S. corporations, access by U.S. corporations to foreign capital and the increasing wealth of foreign investors assures this development. The prominent role of U.S. securities markets and the securities industry can continue, but is not assured. This issue is one which has not been adequately explored or considered and which I will leave for a future talk.

Building the Bases for Regulatory Analysis

In general, the rapidly changing conditions in the capital market and securities industry have combined with the growing responsibilities of the Commission to make the task of responsible regulation more difficult. The techniques and approaches to information gathering and analysis which, in my view, have served the needs of the Commission so well historically may no longer, of themselves, be sufficient. Through the rulemaking and comment process the

Commission has been reliant, to some extent, on the views submitted by interested observers. This is particularly true for empirical and institutional information about the basic operating implications of current regulations and the possible impact of their modification.

Quite understandably, as the body of regulation has grown, firms and individuals have planned their business practices according to their assessments of the guidance provided by current regulation and their expectations of likely future policy approaches. Thus, new rules which are actually proposed and which may be at some variance with what was expected, come as a pleasant surprise to some and a rude awakening to others. And those who believe their business interests are to be helped or hindered by changing regulations cannot be faulted if they make the best case for or against adoption. However, this does mean that, fairly early, a rulemaking process which started out, or should have started out, as a basic information gathering exercise, begins to reflect self-interests and takes on an adversarial tone.

In order to increase the amount of basic information and analysis available to the Commission on a continuing basis, we have embarked on a number of projects. The conduct of these explorations will not be dominated by a single theory, discipline or Division at the Commission. While the processes I will discuss indicate the beginnings of, and need for, a more forceful use of the tools of economists in the regulatory process, we do not yet know how useful that will be in a field so influenced by legal considerations. But, as Richard Posner points out in his recent article on the uses and abuses of economics in law, "(O)ne can reach the outer bounds of a discipline only by pushing outwards. Eventually a point will be reached where the economic theory ceases to have substantial explanatory power. Then we will know the limitations of the economic analysis of law; we do not know them yet." 3/ I am satisfied that those limits have not yet been approached at the Commission. Care must be taken, however, to assure that no single approach to regulation or research is emphasized to the exclusion of others. We need to understand too much for us to ignore any avenues to knowledge.

These activities do represent an increased emphasis on objective empirical approach. They focus on taking information, much of which we already have, some of which will be acquired, and organizing and assimilating it. When quite elementary questions of who, or how much, or for how long

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3/ Richard Posner, Some Uses and Abuses of Economics in Law. 46 Univ. of Chicago Law Rev. 281, 297 (1979).

are asked early in the analytical process, we hope to have some answers. In addition, we hope to contribute wherever possible to the quality of public discussions of our views and our regulatory initiatives. The institutionalization and wide dissemination of the Commission's 1978 Staff Report is part of that commitment. I continue to encourage industry comment on this analysis, and on other reports produced at the Commission.

There are several other projects I would include as part of this growing commitment to basic analysis. The recently announced cooperative effort between the Small Business Administration and the Commission's Directorate of Economic and Policy Research has the ambitious goal of examining the role of regional broker-dealers in raising equity capital for corporations -- including the smaller regional issuer. It will be the first comprehensive government study of the role that regional broker-dealers play in bringing such issues to market, as well as the marketmaking and securities research activities of regional firms.

This study of equity offerings is not the first time the Commission has addressed analytically its regulatory impact on emerging enterprises. The Experimental Technology Incentives Program, conducted by the Directorate in conjunction with the Department of Commerce, is entering its third year at the Commission. This project combines issuer and market information from several sources. It is designed to give us information on the possible effects of rule changes on issuers, particularly smaller and innovative enterprises. The program has already yielded useful results in such areas as the consideration of modifications of Rule 144's restriction on the resale of securities.

In a complimentary fashion, the recently established Office of Small Business Policy within the Division of Corporation Finance is now in the process of gathering and organizing information on the characteristics of smaller issuers. This data should be quite useful in any reconsideration of the appropriate scope of the Commission's requirements for firms registered with the Commission pursuant to the provisions of the 1934 Act.

The Division of Market Regulation has also been involved jointly with the Directorate in the monitoring of important developments in its areas of responsibility. Reports have been produced, and will continue to be produced, on the monitoring of the Intermarket Trading System and the Cincinnati Stock Exchange Multiple Dealer Trading System as parts of the development of a National Market System. And, only a few weeks ago, the Division and the Directorate completed an analysis of a survey of over 600 broker-dealers on the effects of Section 11(a) on exchange member money managers.

In early December, the Commission will consider the public release of this data, aggregated so as to preserve the confidentiality of the survey respondents, in order to facilitate the public discussion of the effects of the Section and the rules promulgated thereunder.

Several different elements at the Commission, as you are probably aware, are currently reviewing the Commission's approach to market surveillance. We are hopeful that several parts of the proposed computerized surveillance system will produce information which will be of general use in analyzing conditions in the securities market and the securities industry.

These activities highlight the Commission's awareness of the value of objective, empirical research to both the rulemaking and rule monitoring processes. But, as I have pointed out, the Commission is evermore frequently asked to take part in public policy discussions and it has the responsibility to comment intelligently on the possible impacts of regulatory initiatives on the securities industry. The Commission cannot and will not simply advocate the securities industry's interests. It can, however, bring to these discussions the viewpoint of a knowledgeable observer, sometimes bringing a unique piece of factual analysis to the debate.

The Commission's interest in analysis is not limited to that done by its own staff. The questions which might be raised in any examination of the emerging trends affecting the industry are exceedingly complex. Are there areas where the industry faces a disadvantage relative to other classes of competitors due to government policies? Do the workings of the net capital rules have implications for the concentration or diversification of the industry? Do the current requirements for regulatory capital impinge inappropriately on the industry's willingness to bear risk or its ability to respond to a sudden expansion in trading volume or margin activity? The industry has been quite responsive to my request for an analysis of these kinds of questions. You can be sure that your views will be given quite careful consideration.

Still, I am left with the sense that there remains a number of areas in which more, or more finely drawn, systematic information would be useful to have. Certain information, best collected by the Commission, may serve as the stimulus for analytical studies conducted by academics or industry groups. Thus, and with your cooperation, we intend to re-examine our broadest information-gathering instrument -- the FOCUS Report. Can the industry's financial reporting system be modified, while keeping a close check on the cost of reporting and on data confidentiality, to provide increasingly relevant information that will enable firms in the industry to better assess their performance and plan their future? Can we devise useful measures of industry capacity and capacity utilization, for example, over its major product lines? Financial information which yields a keener appreciation for industry costs, revenues and their interactions should provide an enhanced analytical framework for the Commission. Perhaps as importantly, a sounder foundation of general knowledge for the business planning efforts of the industry should contribute to its ability to anticipate and to adapt to our rapidly changing financial environment. With the kind of cooperation which I think is in our mutual interest, we will work to have a modernized FOCUS Report available for the filings commencing in January 1981.

The kinds of investigations we have just discussed are sufficiently broad and complicated to warrant various independent analytical efforts. Studies or comments prepared by an industry group, an interested firm or an individual do not have to be linked to a specific rule proposal or Commission initiative. I encourage such efforts and look forward to the insights they will provide.

The 70's have been a decade of turmoil for us as a Nation. The members of the securities industry are acutely aware of this. Although we cannot expect a quick return to times more simple and less demanding, I believe that the experience of the past decade has helped to prepare the securities industry for the challenges which lie ahead. In the vast panorama of events -- of foreign crises, of domestic distress -- the securities industry may seem to be a small player. Yet, by its very nature as an integral part of our competitive and capitalistic society, particularly with regard to its role in the capital allocation process, the industry is bound to reflect the economic and social conditions which surround it.

The nature and extent of the problems which we face should not be underestimated. I believe, however, that a framework for positive economic actions may be evolving. We have recently observed the adoption of strong anti-inflationary measures. We have also begun to seriously examine the disincentives to savings and investment which have accumulated in our public policies. As I was able to observe first hand, last year's Congressional hearings on capital gains taxation and the subsequent enactment of reform, are suggestive of a growing interest in the resolution of basic economic problems. This interest must be nurtured and encouraged to expand. A national commitment to the control of inflation and the growth of capital must be established if our society is to thrive in the decade of the 80's. A renewed focus on the incentives to saving and real investment must prevail and the securities industry must vigorously support this development and be prepared for it whenever it comes.

In any event, we must strive to prepare ourselves for the coming challenges by understanding, as best we can, the conditions which surround us and the signals they send us about things to come. A full recognition of the problems and promises of the coming decade by no means guarantees success, but it is an absolutely essential element of the process which can make the 80's a time of achievement and prosperity for the securities industry and the Nation as a whole.