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BY HAND

January 29, 1981

CONFIDENTIAL

Honorable Edwin Meese, III
Counsellor to the President
The White House
Washington, D.C. 20500

Dear Mr. Meese:

The undersigned is a former Commissioner of the Securities and Exchange Commission (1973-1976). Except for the time on the Commission I have practiced corporate and securities law since 1950 in Cleveland and Washington and have been active in a number of bar association groups concerned with such matters. The following reflections are essentially my own; however, as I shall indicate below, I think they express the sentiments and convictions of a substantial number of lawyers who practice in the securities area.

During the course of the annual University of California, San Diego Securities Regulation Institute last week the contents of the Report of the Transition Team relating to the Securities and Exchange Commission became known through newspaper accounts, and, in the case of some people in attendance at that conference, by procuring a copy of the Report. Because of the intense interest and concern expressed informally to me by attorneys at the conference, I convened a meeting of about 25 attorneys, all of whom have had extensive experience in securities law. Many of the attorneys were formerly members of the staff and several were formerly SEC Commissioners. They represented political convictions ranging all the way from extremely conservative to moderately liberal. All of them have constant dealings with the Commission and its personnel. They represent a broad geographical dispersion and all have been actively engaged in activities related to securities law, such as the American Bar Association Federal Regulation of Securities Committee, local and state bar association groups concerned with securities law, and so on.

These attorneys, despite the variances in their backgrounds, and despite disagreement with regard to details of the Transition Report insofar as they were known, were remarkably united in certain viewpoints and they authorized me to communicate those to you.

In an effort to be sure that we were not jousting with straw men I asked a couple of the attorneys at the meeting who had secured copies of the Report to inform the group

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whether the reports on its contents contained in the Legal Times and the Wall Street Journal were substantially accurate. They confirmed that they were.

I would like to summarize the convictions of this group briefly.

1. With regard to the Chairmanship of the Securities and Exchange Commission, the concern of the group was that whoever is appointed be a person whose integrity, experience, maturity and ability to relate to others at the Commission, Commissioners and staff alike, be unquestionable. Moreover, it is imperative that such a person be possessed of the qualities of leadership. Policy at the Commission is by no means made by one person and the ability to lead the other Commissioners and the staff in the development of policy is every bit as important at the SEC as it is in any other organization.

I think anyone who has dealt extensively with the Commission, and certainly those who have served either on the Commission or its staff, can affirm that politics and ideology have been singularly lacking in Commission activity. During the time I served on the Commission, there were three Republicans and two Democrats. A person could have listened to the deliberations of the Commission for months and years and been unable to identify the Republicans and the Democrats. This has been characteristic of the Commission from its inception in 1934 with rare, rare lapses. Consequently, it was the general belief of the group that personal characteristics should be in the forefront in selecting a Chairman, recognizing, of course, that anyone selected would and should be a Republican.

2. While all of us have had concern with extensions of the Commission's authority in the enforcement area, nonetheless it was the general belief of the group that the decentralization of enforcement activities to state administrators and Commission regional offices would adversely affect the ability of the Commission to carry out Congress's mandate that it enforce the securities laws. The administration of the state securities laws is uneven, ranging from almost total ineffectiveness to extreme vigor. Moreover, the "bite" of those laws themselves varies considerably. While the situation is certainly not as it was in the early 1930's, nonetheless some of the reasons that brought about enactment of the federal securities laws are still valid. States have jurisdictional problems and are often unable to reach witnesses and investigation targets effectively. Again, their personnel are not skilled in the investigation of complicated securities matters and they operate in many cases under severe budgetary constraints. In some instances personnel of state securities authorities have been unable to attend critical meetings of their associations because of the lack of funds. While the regional offices are generally well led, the personnel in them, simply because of the nature of their work, have not had the experience or achieved sophistication in dealing with complicated securities enforcement matters. The effectiveness of the Enforcement Division's activity,

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of course, is not isolated from capital formation: only a public that believes the markets are honest and well-policed will risk its money in them.

3. While the Commission's budget has grown, largely as a consequence of inflation, the size of the Commission staff in recent years generally has not. At the present time the Commission staff is only about five percent larger than it was in 1975; the Report acknowledges that "the total number of employees has remained relatively unchanged during the previous four fiscal years. . . ." Within the Commission shifting emphases have resulted in various divisions growing or contracting, but generally the size of the Commission has remained the same. This has happened notwithstanding the fact that under the 1975 amendments to the securities laws the Commission's responsibilities were substantially expanded, embracing for the first time transfer agents, clearing agencies, oversight of the Municipal Securities Rulemaking Board, increased oversight responsibility with regard to other self-regulatory organizations, and so on. Moreover, as new investment media have developed (options, futures contracts and so on) the Commission's responsibilities have grown. Prior to 1973 there was no trading of fungible options in any organized market. Now the volume of that trading rivals the long-established exchanges, which has created novel and complex regulatory problems.

The group, while recognizing that there are undoubtedly places where the Commission could economize in money and people, does not believe that cuts on the order suggested in the Transition Report could be accomplished without very severely undermining the effectiveness of the Commission in carrying out the work mandated by Congress. A cut to 1,252 people would bring the Commission back to its size in 1962 when the average volume on the New York Stock Exchange was 3,818,077 shares per day (compared with 41,870,725 shares per day in 1980), when there were no option markets, before the Commission had the responsibilities given it by the 1975 Securities Acts Amendments and when the population of the country was almost twenty percent less than it is at the present time. In 1962 no unlisted companies were required to file proxy statements with the Commission and most of them were not required to file periodic reports (about 2,400 companies filed reports in 1962 and about 10,000 presently file). There was no Freedom of Information Act, no Privacy Act, no Foreign Corrupt Practices Act, no reporting by institutional investors under Section 13(g) of the 1934 Act, and relatively few tender offers, all of which presently require considerable staff time.

4. The proposal of the Report that a virtual clean-sweep of the top positions on the staff be made would be disastrous. In the first place, because of pay limitations and conflicts legislation, the recruitment of competent people to serve on the staff has been severely hampered. Accepting a staff position, particularly one at a senior level, often entails considerable financial and personal sacrifice and as the years have gone on the difficulties of recruiting people for such positions have been aggravated. Beyond that, a blanket judgment with respect to the ideological commitments and competence of

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directors and associate and assistant directors is patently erroneous. In some instances the people at the head of divisions have strong conservative leanings. While their respective competences will vary, in virtually every instance they have served the public intelligently and well. To dismiss virtually all the top officials in the fashion in which the Transition Report urges can only have a devastating effect on morale throughout the Agency.

5. Finally, in reviewing the Commission's budget, it should be borne in mind that in large measure the Commission generates the funds it spends through various fees. From 1970 through 1979 the percentage of its budget provided by fees has ranged from 42 to 71 percent and has averaged almost sixty percent. With reasonable adjustment of the Commission's fee schedules the Commission could easily become totally self-sustaining.

With respect to some particulars the Report has value: for instance, unquestionably the Enforcement Division has pursued cases which it was unwise as a matter of policy or uneconomic to pursue, and there has been "nit-picking" in connection with the review of filings (although fairness compels the observation that this is in some measure at least attributable to the need to use new and relatively inexperienced personnel to perform this job). However, it would be unfortunate if an incoming Chairman were led to believe that he was under a mandate to carry out the program outlined in the Report; this might well destroy an agency described in the Report as having a "deserved reputation for integrity and efficiency".

I would be pleased to meet with whomever you may designate to discuss this matter further and I know those who attended the meeting of which I spoke would be similarly available. Moreover if you wish a closer and more detailed analysis of the Report, either this group or the American Bar Association Committee on Federal Regulation of Securities would be pleased to furnish it.

Respectfully yours,

A. A. Sommer, Jr.

AAS/jrd