SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

July 17, 1981

The Honorable James A. Baker III
Chief of Staff and
Assistant to the President
The White House
Washington, D.C. 20500

Dear Jim:

The attached draft summarizes my views concerning the critical necessity to eliminate excessive regulatory burdens and accelerate our flagging rate of capital formation, and it describes the deregulatory actions being taken at the SEC.

Any comments and suggestions would be sincerely appreciated.

Sincerely yours,

John S.R. Shad
Chairman

Attachment

The SEC and Capital Formation

Securities and Exchange Commission
Chairman John S.R. Shad
July, 1981

The Securities and Exchange Commission's primary responsibilities are investor protection and the maintenance of fair and orderly markets. Properly administered, these activities facilitate capital formation.

Some do not appreciate that capital formation means, among other things, savings invested in modern efficient equipment in order to increase workers' productivity. For example, earth movers to replace shovels. And of course, the greater workers' productivity, the greater their pay, standard of living and the nation's growth.

Background: Congress has directed the Commission to conduct forums on capital formation. In this connection, it should be noted that within the brief span of a generation, America's tax, fiscal and regulatory policies have become antithetical to capital formation.

Mounting regulatory burdens, rising inflation, corporate and individual taxes, inadequate depreciation allowances, double taxation of dividends, up to 70% taxes on interest and dividends, and one of the highest effective rates of capital gains taxation in the industrialized free world, have been emphatic disincentives to save. Instead of saving and investing, many Americans have been forced or induced to spend their savings -- eat their seed corn.

Directly or through banks, pension and mutual funds, savers have historically purchased bonds to preserve capital and stocks as a hedge against inflation. However, the foregoing factors have severely depressed the bond market and the Dow Jones Industrial Average is presently below the 1968 level, despite the 156% interim increase in the cost of living index.

As a consequence of our saving and investment disincentives, America's rate of capital formation has plummeted from one of the highest to near the lowest among industrialized nations. The inevitable consequence has been a similar deterioration in our rates of productivity and growth.

If we are to maintain the standard of living of all Americans and the nation's leadership in the competitive world community, it is essential that these adverse trends be reversed.

<u>SEC Objectives</u>: In terms of its responsibilities, the SEC is a lean organization of approximately 1200 professionals. Through registration and transfer fees, it is self-supporting to the extent of about 65% of its budget.

The Commission is embarked on a major internal program to facilitate capital formation by simplifying the processes of raising capital in our public markets; by reducing excessive corporate registration, reporting and other regulatory burdens; and by maintaining public confidence in our securities markets through effective oversight, disclosure and antifraud enforcement. Deregulation is also facilitating the free flow of capital and commerce throughout the world.

The Commission is implementing the foregoing objectives in the following fashion.

Deregulation: First, by simplifying regulatory processes and procedures.

Director Edward Greene's Division of Corporation Finance is doing an outstanding job. They have initiated exemptions and "short form" registration statements which telescope the paperwork, time and expenses previously required of corporations to do public financings.

Also, within 30 days they will introduce the balance of their "integration package", which will further significantly simplify the registration and reporting requirements of public companies. Essentially, it will consolidate and eliminate duplicative disclosure requirements under the securities laws and regulations. And it will achieve these objectives without compromising the disclosure of essential information to the investing public.

Corporation Finance is also working with the state regulatory organizations on a major unification rule which will provide for exemptions from registration of securities offerings at both the federal and state levels.

The Office of the Chief Accountant, under Clarence Sampson, is engaged in a detailed review of the SEC's Accounting Standards Releases, with a view to pruning and simplifying them. Important initiatives in this area will also be announced within 30 days.

The Division of Market Regulation, under the direction of Douglas Scarff, is conducting an intensive review of broker-dealer net capital and related regulations with a view to assuring their financial stability, without unduly diverting their capital from more productive uses. The results of this comprehensive review are due this fall.

The Division of Investment Management has reduced investment company regulations and reporting requirements and delegated greater responsibilities to their independent directors. Director Joel Goldberg plans to announce additional investment company deregulatory initiatives this fall.

Under the Public Utility Holding Company Act, 14 of the nation's largest utilities are required to obtain prior Commission approval of their financing, merger, acquisition and other important decisions. Aaron Levy's Division of Corporate Regulation is carefully reviewing these regulations and procedures.

Under General Counsel Ralph Ferrara, his Office is assisting and advising the foregoing divisions in the implementation of their deregulatory programs. Acting Director Jeffrey Davis' Directorate of Economic and Policy Analysis is also effectively supporting these essential efforts.

The Commission is also attempting to dissuade a segment of the SEC bar from the questionable practice of "overkill compliance" with disclosure requirements. They understandably wish to protect their corporate clients from enforcement actions and civil suits.

However, such protection can be achieved with a rifle much more effectively than with a blunderbuss. Ponderous prospectuses, proxies and 10-Ks, larded with disclaimers, boilerplate and legalese, obfuscate rather than inform. They also demean and discredit such companies in the eyes of securities brokers, analysts, investment and commercial bankers, insurance companies, major customers, suppliers, key personnel and the press. Consequently, such companies do not generally enjoy as favorable public images or markets as issuers which provide informative, succinct, balanced disclosures that truly serve the intent of the securities laws.

Public Confidence: Second, the Commission is facilitating capital formation by maintaining the confidence of the nation's 30,000,000 investors in the integrity of our securities markets through effective oversight and antifraud enforcement.

Oversight: The Commission's principal areas of oversight responsibility include the nation's 8,000 publicly owned corporations, 7,000 investment banking and brokerage firms, ten securities exchanges and the over-the-counter markets, 1500 registered investment companies and 6,000 registered investment advisers, 850 accounting firms, the Securities Investor Protection Corporation (SIPC) and 13 major public utility holding companies.

The following SEC oversight programs are under review:

> The Commission's computerized Market Oversight and Surveillance System (MOSS) is a pilot program to audit the surveillance functions of the securities industry's Self-Regulatory Organizations (i.e., the exchanges and the National Association of Securities Dealers). The program is presently under review, in

consultation with the SROs, to assure that inter-market trading activities are properly monitored, that individual market surveillance programs are strengthened where needed and that Moss does not unnecessarily duplicate the SROs' functions. These programs identify anomalous trading activities that suggest abuse of inside information, market manipulation and other fraudulent activities. The reviews in process will address the means of achieving these objectives more efficiently.

The Chief Accountant's Office is working closely with the accounting profession's SROs, including the American Institute of Certified Public Accountants and its Public Oversight Board (POB), the Auditing Standards Board (ASB) and the Financial Accounting Standards Board (FASB). Later this year, the Office of the Chief Accountant will be afforded access to certain peer review work papers, in order to assess the effectiveness of that program.

The objective will be to substantially reduce the Commission's direct oversight by placing greater reliance on the POB. The Chief Accountant is also exploring ways for the ASB and FASB to assume greater oversight responsibilities and reduce the Commission's direct involvement in their areas.

A critical aspect of the Commission's oversight responsibilities is the financial stability of the securities industry. The failure of a major firm could have a drastic snowball effect on the industry because of the large volume of open transactions between firms at any given moment. The Federal Deposits Insurance Corporation has the authority to facilitate mergers of failing banks. Whereas, SIPC, which is largely self-supporting, only has authority to liquidate failing securities firms. Liquidation is drastic, time consuming and expensive. Also, SIPC does not insure balances due other securities firms. The Division of Market Regulation is analyzing these and related areas with a view to assuring investor protection and the financial stability of the securities industry.

At the present time, the Commission is supervising directly the nation's 1500 registered investment companies and 6,000 registered investment advisers. The Division of Investment Management is reviewing alternative means of creating effective self-regulation of these important activities.

Antifraud Enforcement: John Fedders, the new Director of Enforcement, with the support of one of the most capable enforcement organizations in government, will continue to enforce vigorously antifraud prohibitions, with emphasis on organized criminal activities, abuse of inside information, market manipulation and fraud.

In order to encourage prompt voluntary corporate compliance, in the absence of additional information beyond that voluntarily disclosed, less emphasis will be placed on the investigation of companies that promptly correct erroneous or inadequate disclosures and take appropriate remedial actions.

Foreign Investment: Thirdly, the Commission is aiding U.S. capital formation by facilitating foreign investment in our capital markets (i.e., the importation of capital from abroad).

Foreign investment is being facilitated through the admission of foreign brokers to membership in U.S. exchanges. The Commission is also working with the exchanges and international authorities, with a view to easing foreign firms' and institutional investors' compliance with U.S. regulations.

Through deregulation the Commission is facilitating the free flow of capital and commerce throughout the world. It is also reviewing certain foreign barriers, with a view to facilitating greater access by U.S. corporations to capital markets abroad.

While major U.S. corporations have ready access to the Eurodollar market, which occasionally affords more advantageous financing terms than here, U.S. corporations' direct access to the internal capital markets of many countries are severely restricted. The question posed is whether we should facilitate exportation of capital from the U.S. to expand and modernize production facilities in industrialized countries which enjoy higher rates of capital formation, productivity and growth than we do, but which do not afford U.S. corporations equal access to their capital markets.

In conclusion: The Commission's successful efforts to date in the foregoing areas are a testimony to its distinguished Commissioners and outstanding staff. Through their diligent, innovative efforts, the Commission will make an increasing contribution to capital formation in America.