TESTIMONY OF THE HONORABLE RAY GARRETT, JR., CHAIRMAN, SECURITIES AND EXCHANGE COMMISSION, BEFORE THE SUBCOMMITTEE ON HUD-SPACE-SCIENCE-VETERANS, COMMITTEE ON APPROPRIATIONS, UNITED STATES SENATE, ON THE SECURITIES AND EXCHANGE COMMISSION'S FISCAL 1975 BUDGET ESTIMATE

May 13, 1974

Mr. Chairman and members of the Committee, it is a pleasure for me and my fellow Commissioners to be here with members of our staff to discuss with you the planned activities and the financial requirements of the Securities and Exchange Commission for the fiscal year beginning next July 1.

My prepared statement outlines some of our accomplishments and problems during the past fiscal year, where we stand today, our outlook for the next fiscal year and our additional financial requirements for the next year. Rather than read that statement this morning, which I understand will be made part of this Subcommittee's record, I should like to summarize some of the highlights of our current position, plans and financial needs.

Before I do that, however, on behalf of the Commission, I want to express formally our appreciation to this Subcommittee for its especially understanding and perceptive treatment of our budget request last year. Your Subcommittee recommended, and the Congress eventually authorized, the funds to provide 204 positions above our request for this fiscal year.

As a result, for the current year, 1974, we have an estimated total of almost $36.5 million - - including a pending supplemental appropriation for pay increases - - funds which provide us with an authorized staff of 1,919.

We are requesting $42,131,000 for next year, an increase of $5,677,000 over this year's budget authorization.

In your evaluation of our request, we should like to stress two points:

First, although the Commission receives its funds solely from Congressional appropriations, we return substantial sums to the Treasury each year as a result of the fees paid by persons and entities subject to our jurisdiction. In a number of years, these fees have returned more than 70 percent of our budget to the Treasury. If our budget request is approved, the net cost of our operations to taxpayers will not be anything approximating the $42.1 million we have requested; indeed, based on our estimated fee collection, the actual net cost of our program should not exceed $23 million. Based on our current fee schedule, we expect to collect and deposit in the Treasury approximately $19 million, or 45 percent of our budget request. This is a smaller than normal percentage of our expenses for two basic reasons: first, the depressed market conditions have greatly reduced securities offerings and our resultant revenues from offering fees. Second, two recent Supreme Court decisions have cast doubt on the legality of certain fees levied under Title V of the Independent Offices Appropriation Act of 1952. We are currently reviewing our entire fee schedule in light of those decisions, and estimate our revenues could decrease by as much as $5.2 million in this fiscal year because of them. If public securities offerings should increase to the levels we have experienced in the past, the revenue we return to the Treasury could be larger. Legislation presently pending before the House of Representatives - - H.R. 5050 - - would, if enacted, substantially increase the fees we receive from the national securities exchanges registered with us pursuant to Section 6 of the Securities Exchange Act of 1934.

The second point we wish to stress is that approximately $4.8 million, or 84 percent of the increase we have requested, is required to satisfy four mandatory items. They are:

a.	Net cost of office space in fiscal 1975, previously paid out of GSA appropriations.	$2,281,300
b.	Cost of sustaining 263 new fiscal year 1974 positions for the full fiscal year 1975, compared with an average of 5-1/2 months in 1974.	1,650,000
c.	Mandatory within-grade increases. positions for the full fiscal year 1975, compared with an average of 5-1/2 months in 1974.	380,000

d.	Additional cost of pay increases in fiscal 1975, which became effective on October 14, 1973.	484,000
	Total	$4,795,300

This leaves $900,000, which will allow a staff increase of 75 positions.

Before I describe the specific use we propose to make of these 75 additional staff members, let me furnish some perspective on the Commission's increasing responsibility in the year ahead.

The financial machinery of this country, as well as the governmental entities charged with the responsibility for its leadership and governance - - particularly the Congress and the SEC - - are faced by severe challenges. We have tried to give some small indication of these challenges through the simple exhibits which are incorporated in my statement, and which I will refer to as I talk. Even though public offerings of equity securities have been down relative to prior years, presumably because stock prices have been down, the total demands for new capital that America is now making, and will make, on our financial markets have increased markedly over the past few years. Some rather astronomical figures are currently being cited for the amount of capital that American industry will need for new investment over the next ten years. The most dramatic figure, I suppose, in the current energy crisis environment, is one economist's estimate that the petroleum industry alone will need $1.3 trillion of new investment through 1985. Other industries have estimates which, though perhaps less dramatic individually, are in the aggregate equally impressive, and satisfying their needs will be just as important if our country is to retain its ability to produce the goods and services needed to maintain our high standard of living and compete effectively abroad. As an example, Chart 1 in my statement indicates that four selected industries which plan capital expenditures of $17 billion in the year 1973 expect to need $40.8 billion, two and one-half times as much, in the year 1985.

At the same time, the amount of money that our citizens and institutions have committed to the stock market has also increased impressively. Individual investors apparently are disillusioned with traditional equity investments, a matter of great concern; but, notwithstanding this fact, funds invested by individuals in traditional equity investments have increased, from $437 billion in 1966, to $731 billion in 1972, as shown in Chart 2. Simultaneously, the funds invested by non-insured pension funds, the basis for the expected future well-being of millions of Americans, have grown from $37 billion to $115 billion. And, over the same seven-year time frame, as illustrated on Chart 3, the number of companies required to file periodic reports with the Commission has almost doubled - - rising from 5,200 to our current figures of 9,100.

At the same time, questions concerning the effectiveness and capability of our securities markets have surfaced with disconcerting frequency. As shown on Chart 4, the decline in the number of companies able to raise money through equity offerings over the last two years has been so sharp that one financial publication has stated that "the flow of capital to American business has ceased." And the financial viability of the securities industry to meet our economic needs is also being questioned increasingly, in part because, in the three brief years since the Congress so wisely established the Securities Investor Protection Corporation - - "SIPC" - - 96 firms, or approximately 2 percent of the firms in the industry, have failed and been liquidated by SIPC [see Chart 5]. Last, but not least, the number of defendants we enjoin for violating securities laws continues to increase [see Chart 6].

Despite these statistics, I believe the securities markets are capable of meeting the difficulties to which I have alluded. But, I think these figures serve as a valuable reminder of the tough job that both the Congress and the Commission have ahead. They help to explain why 75 additional people are important if we are to continue the task of regulating our securities markets effectively.

Chart 7 summarizes how we plan to use those 75 positions, and their relation to our current number of authorized positions in each of our eight program areas. I would like to discuss briefly our most important needs for additional people. You will see that of the positions requested, 40 of them are for the Commission's largest program - - the suppression of securities fraud; 18 of these are for our central, or home, office, in our Division of Enforcement, and 22 for the enforcement work performed by our regional offices. This increase in enforcement resources, if approved, will help us:

(1) deal with the increased complexity of our enforcement actions;

(2) continue and accelerate a number of high-priority special enforcement programs, such as our highly successful joint task force with the National Association of Securities Dealers; and

(3) accelerate the conclusion of investigations and proceedings.

The increased complexity of our fraud suppression effort is evidenced by the increase in our litigation workload, attributable largely to the increasing number of enforcement actions we have instituted and the increasing tendency of some respondents to litigate rather than settle such proceedings.

A single contested complex case can tie up a number of attorneys and investigators for many months at a time. But we must pursue these cases, regardless of the time required, because of the magnitude of the losses caused to investors and the important deterrent effect on these resulting from successful prosecution. While the record is not in in these cases, for example, it appears that stockholders of Equity Funding Corporation have lost something like $250 million in the aggregate just from the market price drop of February 1973 to date; stockholders of National Student Marketing lost in excess of $400 million in three months; Penn Central stockholders have lost an aggregate of $1 billion at least; and the stockholders of Four Seasons lost $110 million in a matter of days.

Concurrently, with prosecuting cases that are in court, we must carry out increasingly complex investigations of fraud and other violations of the federal securities laws involving such obvious areas as tax-sheltered securities, the activities of organized crime, insider trading, municipal bonds, and real estate schemes. All of these take resources. And, the increased complexity of our cases is accompanied by an increase in the overall number of cases that we apparently must bring to provide an effective deterrent against illegal activity. From 1970 to 1973, the number of injunctive actions we instituted, and the number of administrative hearings pertaining to broker-dealers and investment advisors, jumped 60 percent and 62 percent respectively.

As of December 31, 1973, 734 investigations, and 363 enforcement proceedings (administrative, civil and criminal), were pending. Additional personnel are required to maintain our effectiveness in pursuing investigations and concluding, expeditiously, our pending enforcement actions.

Our second largest requested increase is for 16 new positions for our regulation of markets and broker-dealers. This is a critical area; and the work we are doing in it reflects the increasing extent to which the Commission has recently become involved in fundamental questions of the financial and structural evolution of the securities markets.

During 1973, for example, we took steps intended to lead to the end of fixed commissions on the sale of securities - - a practice which began almost 200 years ago and a matter of critical concern to members of the securities industry. By May 1, 1975, we expect to achieve a fully competitive rate system on all exchanges, and the process of achieving this policy objective will require significant staff effort.

Our work on the structure of the securities markets will also require increased staff in 1975. This work stems from the Commission's March 29, 1973 <u>Policy Statement on the Structure of a Central Market System</u>, based on two major Congressional studies, the work of several industry advisory committees, and extensive analysis by the Commission's staff. Our <u>Policy Statement</u> outlines both the structure and regulatory framework of a market system which will link all markets for listed securities, encourage competition to the substantial benefit of investors, and equalize the regulation of competing markets.

Continued development of the central market system concept will be a major effort in fiscal 1975. Our staff plans to oversee the implementation, and to monitor the performance, of the consolidated transaction reporting system and to guide the development of the composite quotation system. Concurrently, we will analyze and propose a new regulatory framework to support this central market system. This will require harmonizing exchange, NASD and

Commission regulation in areas such as anti-manipulative practices, floor trading, membership and access.

To ensure that the design of the central market system reflects the best thinking of its potential participants and users, the Commission has just announced the establishment of a Central Market System Advisory Committee. This Committee will provide the Commission with the views of knowledgeable people on ways of implementing its proposals for a central market system so as to insure that the system will meet the needs of the United States' capital markets in the decades ahead, consistent with the public interest and protection of investors. The Committee will be asked to submit recommendations to the Commission on such matters and how fundamental policy issues relating to central market system operations, including the provision of adequate facilities for meeting future capital needs, should be resolved, and the appropriate design and implementation time table for specific central market system elements. The Commission had previously announced its general intention to establish such an Advisory Committee in its March 29, 1973 <u>Policy Statement</u>.

The development of widespread interest in the purchase and sale of call "option" - - the right to buy a security at a fixed price at some future date - - in an exchange auction market has involved the Commission in the evaluation and regulation of a highly controversial investment vehicle, which will require increased effort in fiscal 1975.

Because of the many fundamental questions posed by exchange option trading, we plan considerable additional analysis and discussions, recently begun with three weeks of public hearings, as we develop an approach for regulating this new investment vehicle.

The final significant staff increase - - an increase of eight positions - - is requested for our Division of Investment Management Regulation to carry out investment company and investment adviser programs.

There are approximately 1,260 active investment companies and 2,900 investment advisers registered with the Commission under the Investment Company and Investment Advisers Acts of 1940. Because these companies and advisers manage close to $200 billion of investor funds, and because no other agency has any regulatory responsibility for their operations, the regulation of these individuals and companies must receive continued strong emphasis from the Commission.

We have four overall objectives for this program for fiscal 1975. They are:

(1) to respond more promptly to requests of investment companies and investment advisers and their counsel for interpretations and "no action" positions under various provisions of relevant federal law;

(2) to coordinate the Commission's nationwide inspection program of registered investment companies and investment advisers;

(3) to promulgate rules, and amendments to rules, to regularize exemptions previously granted upon individual application; and

(4) to establish a broader and more comprehensive regulatory framework.

The magnitude of the issues to be resolved in strengthening the investment company and investment adviser regulatory framework is illustrated by listing just a few of the more than 40 projects we have underway in this area. They include: (1) consideration of a possible federal regulatory statute for real estate and other tax –sheltered investment vehicles, modeled after the Investment Company Act; (2) possible rule or amendments to our existing laws to permit sales of securities in the United States by foreign investment companies; and (3) review of the investment management activities of banks.

Mr. Chairman, 64 of the 75 additional psotions requested for fiscal 1975 will be employed in the programs I have just discussed. The specific type of positions requested, and the objectives for the four programs in which they will be used are summarized in Chart 8. The remaining 11 positions requested include: 2 positions for our Office of the General Counsel, charged with conducting all appellate and significant district court litigation and rendering general legal advice to the Commission on all aspects of its responsibilities; 1 position for our opinion writing office; 1 each for our Personnel and Comptroller offices, 2 positions for our Office of Records to facilitate better dissemination of information to the public; and four positions for our Office of Administrative Services, to meet more effectively the facilities, transportation and office support needs of our growing staff housed in three different locations in the Washington area.

In total, the 75 positions, then, are allocated to 18 of our 29 units.

I will not take nay more time this morning to describe the mandatory cost increases most of our budget will handle, since that subject is covered in my prepared statement.

At this point, we are prepared to answer any questions the members of the Subcommittee might have.