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DEREGULATION: A SENSITIVE UNDERTAKING REQUIRING ADEQUATE RESOURCES

ADDRESS BY

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Symposium on Securities Regulation and the Capital Raising Process for Small Issuers
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I appreciate being asked to participate in this symposium with you because in a very real way all of us either are or probably intend to become part of a government-private sector relationship dealing with the offer and sale of securities. We have had an opportunity this morning, and will continue this afternoon, to hear members of the Commission's staff, the bar, and the faculty of this law school discuss various aspects of the capital raising process for small issuers. In a securities regulation symposium aimed at small business, naturally a significant part of the discussion must be focused on Commission regulatory requirements and deregulatory initiatives. Because most of your time today has been and will be spent on detailed technical issues, it seems to me that the best contribution I might make would be to share a perspective regarding the roles of the SEC, the private sector, and the professions in the present environment and then to give you an opportunity to ask any questions you might have.

At the outset, some basic comments regarding regulation may be helpful. First, regulatory statutes are products of Congress, not regulatory agencies, and were enacted with clear objectives designed to be responsive to perceived problems. If a given statutory scheme is not accomplishing its stated purpose, or if the purpose has become less desirable, or perhaps infeasible, Congress has the responsibility to correct the situation by changing the law. A regulatory agency generally has some flexibility as to how it administers the law, but it is not appropriate to simply abrogate its responsibilities.

Second, within their statutory mandate and obligations, regulatory agencies should endeavor to devise solutions that are effective without unduly disrupting market forces and participants. An integral part of this process is the review of regulations promulgated over a period of years in response to economic conditions which may have changed in the interim. This necessary self-evaluation, in some instances, should bring about the outright removal of regulations. In other instances it may result in re-regulation in the form of innovative, cost-effective solutions to continuing problems.

Third, deregulation is a two-way street. For the most part, government presence in areas of economic activity has come about because of an apparent public need. Where that need still exists, as it does in many cases, the possibility of diminished government involvement is dependent upon private sector initiatives, including self-regulation.

The Commission's programs to simplify its various regulatory systems, although perhaps more highly publicized

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recently, were not conceived so that we could be in the mainstream of current thinking. A careful look at the SEC's record shows that throughout its history the Commission has been concerned about imposing burdens on honest businesses. This philosophy goes hand in hand with the structure of laws the SEC administers, which is uniquely consistent with a free market economy.

In retrospect, one is impressed with the foresight of Congress in determining that mandating the full and fair flow of information would provide a powerful incentive for honesty and fair dealing by public corporations and that investor confidence in the securities markets would thus be rehabilitated and enhanced. One must also be impressed that the structure of our securities laws has permitted the Commission to rely, perhaps more heavily than any other agency, on private sector self-regulation and self-discipline in carrying out its responsibilities to protect public investors and assure fair, honest and efficient markets.

No regulatory scheme is effective unless there is compliance with its requirements. Although most businessmen and securities professionals, like most other citizens, are honest and desire to comply with laws and regulations and maintain appropriate business and professional standards, the profit motive, which is the driving force in a free enterprise system, can be so powerful as to result in dishonesty, fraud, unfairness, and an unacceptable lowering of standards. Experience has also shown that in addition to those few unscrupulous promoters who perceive public investors as easy prey for skillful schemes, the pressure to produce profits or avoid losses sometimes causes otherwise respectable, law-abiding individuals not to disclose unfavorable material information or favorably shade disclosure regarding what is actually an unfavorable corporate development. Efficient securities markets must have sufficient, current and accurate information to facilitiate rational decisionmaking. Thus, it is necessary to have an effective enforcement program. A strong enforcement presence is even more important in an environment where regulatory burdens are being reduced and the opportunity for possible abuse increased. The Commission's enforcement program is known as the best in the Federal Government. Nevertheless, we have always had to depend heavily on the professionals in private sector to perform certain compliance functions.

Although issuers have primary responsibility, professionals involved in the preparation of disclosure documents have a unique and critical role in securities law compliance. Often, the initial decision to offer securities to the public is predicated and dependent upon their judgments. Because of the complexity of technical requirements and difficult legal issues involving elusive concepts such as materiality, securities attorneys guide corporations through the drafting of public filings and, in many cases, their legal advice is

the filter through which information is provided to the market. Similarly, the public has come to place great reliance and trust on the accountant's certification that the financial statements fairly reflect the company's financial position and results of operation. These professionals serve as access points to the sale and trading of securities because without their judgments and drafting skills it is very difficult for companies to go public or to sustain a trading market.

Broker-dealers are also pivotal in this system. Underwriters, with their due diligence obligations, have a duty to protect the public by investigating registration statements for misrepresented or omitted material facts. Congress clearly recognized the necessity for an independent review of the registration statement when it imposed a high standard of care and heavy liability on underwriters in Section 11 of the Securities Act. In addition, brokers involved in the distribution of securities are prohibited from making oral representations which are inconsistent with information set forth in the prospectus.

Our securities regulation is largely determined by how attorneys, accountants, broker-dealers, and their self-regulatory organizations fulfill the role intended for them in our securities markets. Because of our statutory obligations to protect investors, we are able to reduce our regulatory involvement only to the extent that private sector participants assure that investors are dealt with fairly.

Now let me turn to some of the Commission's recent and present activities and what can be expected in the future. For at least the past eight years we have been working to remove anti-competitive barriers within our securities markets and have facilitated greater efficiency. As an example, in 1975 the Commission required that exchange rules establishing the minimum brokerage rates for members be abolished. On the basis of prior fixed rates, during last year alone this action saved the public more than the amount of public funds required to support the SEC for over 30 years at present budget levels. In addition, broker-dealers were more profitable, had more capital, and were better managed than ever before.

In the area of deregulating small business, we have reduced the burdens and opened up opportunities significantly through carefully considered changes. We have instituted such changes as Form S-18 which may be filed in regional offices in order to expedite access to capital markets. We have also been working with the North American Securities Administrators Association to develop uniform exemptions from registration requirements on both the State and Federal level and to remove duplicative requirements.

Through imaginative rulemaking, obligations under the Securities Act and the Exchange Act are being integrated so

that issuers can save time and money and investors can benefit from more readable documents. In addition, pervasive regulation of investment companies is being replaced with increased reliance on the fiduciary responsibilities of disinterested directors and we are considering the possibility of establishing a self-regulatory organization for investment companies.

When one considers these actions it is clear that many of our activities have a deregulatory effect. Deregulation is a sensitive undertaking which must be accomplished without undermining an environment in which investors and those seeking capital can have confidence that they are being treated fairly. Otherwise, investors will put their savings elsewhere and firms will find it more difficult and costly to obtain capital. Of course, burdens on registrants that do not provide investor protection or improve the efficiency of our capital markets should be removed, but the task is almost never that simple. Every modicum of regulation has the potential of providing some benefits. The exercise of responsible regulation, therefore, requires that the incremental benefits a particular rule is designed to provide outweigh the anticipated costs of compliance. Because these facts are not subject to precise measurement, the process involves professional judgments, estimates and, in some instances, educated guesswork.

The coordination of difficult regulatory schemes, simplification of complex requirements, balancing of competing interests, and the identification of areas ripe for reform requires the talents of many experienced staff members with an intimate knowledge of, among other things, the relevant law, administrative lore, accounting literature, professional standards and market practices. It must be obvious that thousands of hours of research, deliberation and drafting are reflected in our recent integration and Regulation D proposals. Unless one is able to dismiss the SEC's existing rules as devoid of merit and is willing to summarily rescind them, deregulation amounts to a time-consuming, people-intensive undertaking.

Looking to the future, it is extremely uncertain how the Commission is going to be able to fulfill its responsibilities, let alone continue with efforts to ease regulatory burdens.

In many respects, the Commission is a service agency which provides assistance to corporations and their professional advisers as they seek capital from investors and facilitates fair and honest markets in which those securities can be valued and traded. In the past, the Commission has provided substantial assistance to those seeking capital through interpretive advice, reviewing filings, and helping issuers meet their disclosure responsibilities through the comment process. In order to provide issuers and their advisors easy access to staff practice and positions regarding important topics, the Commission, at significant expense, has published numerous comprehensive

releases which synthesize and analyze literally thousands of no-action and interpretive letters as well as oral positions given over the years. Among these are releases on Rule 144, employee plans, Section 16 of the Exchange Act, management remuneration, going private transactions and anti-takeover measures.

Recently, as you know, the President proposed a 12 percent across-the-board budget cut for all federal departments and agencies. If such a cut is applied to the Commission, it would have a profound effect on our activities. Not only would we be unable to sustain our efforts toward deregulation, we would be required to reverse some of the actions we have taken to facilitate capital raising for small issuers and curtail services provided to securities professionals and public investors. We would be forced to make deep cuts in training, library support, computer services, printing, office space, telephone facilities, heating and air conditioning. Regional public reference facilities and virtually all of our efforts to become more efficient through the use of modern technology would also be terminated. Moreover, we would be required to reduce examination programs; eliminate regional office disclosure and bankruptcy programs; and consolidate or close the Division of Corporate Regulation, the Office of Opinions and Review, our investor complaint unit, one regional office and five branch offices. Other divisions and offices throughout the Commission would be reduced in size. Overall, a 12 percent reduction would require us to decrease our staff by about 400 individuals or approximately 20 percent in just 1982.

What does that mean to you and our securities markets? First let me make it clear that the Commission has, at least in the recent past, been considered by both Congressional and private evaluations to be one of the best if not the best of government agencies. We are proud of our efficiency and our reputation for professionalism and I assure you that we will do all we can to retain these qualities. But it should be recognized that our staff, which has never been large, is smaller now than it was five years ago and yet the activities over which we have jurisdiction have become much more complicated and increased several-fold. The very fact that we do not have excess capacity and even now are not able to fully fulfill our responsibilities will mean that the proposed cut, if approved, would have a major impact on our performance. Our situation reminds me somewhat of the farmer who in order to reduce costs, gradually replaced the hay and oats he was feeding his draft horse with straw. When asked how he was doing, he responded: "It seemed to be working out very well but just when I had almost replaced all the other feed with straw, my horse died." In my view, our staff has always been the best and has generally been willing to work long hours in order to help maintain a strong and effective agency. It must be understood, however, that there are mental and physical limits and that it is not possible to continue to increase burdens and responsibilities,

permit annual declines in the purchasing power of their salaries, and reduce their numbers by 20 percent and yet expect the same quality of performance.

A 12 percent cut in the budget of the Commission would, among other things, reduce our enforcement capacity; decrease our ability to provide interpretive advice; curtail our amicus curiae presence in federal courts and impair other legal services; weaken our ability to oversee securities markets; eliminate a division and several offices in Washington and close a regional office and several branch offices; reduce examinations of broker-dealers, investment companies and advisers; eliminate review of repeat filings and two-thirds of initial filings registering new securities; and undermine our ability to further deregulate. All of this would occur at a time when a concerted effort is being made to increase investment and economic activity and reduce government regulation. I do not believe the proposal to reduce the SEC's budget by 12 percent is in the public interest and when the facts are considered by Congress, I expect them to come to the same conclusion. I believe that instead of a decrease, an increase in our budgetary resources would be more conducive to achieving the administration's economic and deregulatory goals.