



**NEWS**

**SECURITIES AND  
EXCHANGE COMMISSION**

Washington, D. C. 20549

(202) 272-2650



Post-War Trends and  
Recent Developments in the Market  
and at the SEC

John S.R. Shad  
Chairman  
Securities and Exchange Commission

National Security Traders Association  
Boca Raton, Florida  
October 9, 1983

Ladies and Gentlemen:

It is a pleasure to be with you at the 50th anniversary convention of the National Security Traders Association. It is nice to be with so many old friends - for a change.

The other day I was asked if I knew what a "Damn Shame" is. I learned that a Damn Shame is a busload of government officials going off a cliff - with 5 empty seats.

The 50th anniversary convention of the NSTA . . . The NSTA has come a long way since the two million share days and the "pink sheets" with which many of us started in the business after World War II.

Just within the past 10 years:

- o NASDAQ volume has increased 7-fold to an average daily volume of 60 million shares;
- o and the NASDAQ Composite Index has risen 5-fold to over 300.

There are now over 28,000 marketmaking positions in NASDAQ stocks -- averaging 7 market makers per security. 3,500 NASDAQ securities are quoted in the press; and about 95,000 terminals display NASDAQ quotes throughout the world.

So far this year NASDAQ's share volume has exceeded the New York Stock Exchange's on 6 occasions -- and has averaged nearly 75% of the NYSE's volume. Based on dollar volume, NASDAQ has long been the world's third largest securities market. This year's estimated \$200 billion dollar NASDAQ volume ranks behind the NYSE's \$750 billion, but it's closing in on Tokyo's \$215 billion, and it's a multiple of London's \$90 billion, and the Amex's \$35 billion dollar annual volume.

These are phenomenal results. Talk about a national market system, it's here - it's NASDAQ. Phenomenal progress has been made and more is in prospect.

Today, I would like to highlight some post-war trends and recent developments in the market and at the SEC.

#### Capital Formation

Since the end of World War II, many of the nation's regulatory, fiscal and monetary policies have actually been antithetical to capital formation.

- o Mounting regulatory burdens;
- o Rising inflation, corporate and individual taxes;

- o Inadequate depreciation allowances;
- o Discriminatory taxation of interest and dividends;
- o As well as double taxation of dividends;
- o And one of the highest effective rates of capital gains taxation in the industrialized free world;

have been distinct disincentives to saving and investing.

These policies have contributed to the significant decline in our relative rate of capital formation, among industrialized nations. The inevitable consequence has been a similar decline in our relative rates of productivity and growth.

Our less than 2% average annual increase in productivity per man-hour during the last 10 years compares with nearly 6% for Japan and over 4% for western Europe. In other words, Japan's productivity has been increasing at over 3 times and western Europe's at over twice the rate in the United States! Such trends cannot be projected very far into the future, if the United States is to maintain its leadership in this keenly competitive world.

Much has been written about Japan's extraordinary post-war recovery. Some attribute it largely to their unique management by consensus. However, I believe business and economic historians will give greater weight to their encouragement of investments and savings. In Japan, the first \$40,000 of dividend income is tax free and there is no capital gains tax on individuals' securities profits. The annual rate of savings in Japan is 20%, as compared with our 4%. These policies are reflected in their high rates of capital formation, productivity and growth.

We have an excellent labor force in America, but the only way we can materially improve most workers' standard of living is by increasing their productivity - and that takes capital - savings, investments and corporate profits, plowed back into new technology and production facilities, which create new jobs and multiply workers' productivity - thereby permitting substantial wage increases.

On a favorable note, since 1980:

- o Corporate depreciation allowances have been increased by over 14%;
- o the rate of inflation has been reduced by over 60%;
- o the prime rate by 50%;

- o the maximum federal tax rates on interest, dividends and capital gains have been reduced by over 25%;
- o and the annual growth rate of our productivity has tripled. It is now growing at a 5.7% annual rate, and our GNP at an extraordinary 7% annual rate. Few believe the 7% can be sustained, but even at a 5% rate for the next three years, the huge deficits in prospect will be virtually eliminated.

This year's corporate profits are expected to exceed last year's by well over 25% - and the prospects for next year are excellent.

This is the important point. These increases in investment incentives and reductions in disincentives have been reflected since August of last year in the strongest stock, bond and new issue markets in history, and will be reflected during the balance of this year and 1984 in rising demand for consumer durables, capital goods and jobs.

#### The SEC's Mandate

As for the SEC, by effectively discharging its mandate to protect investors and maintain fair and orderly markets, the SEC facilitates capital formation, as well as the mobility of capital.

America has by far the best securities markets the world has ever known - the broadest, the most active and efficient, and the fairest. With the support and leadership of the financial community, the SEC's job is to help keep them that way.

#### Enforcement

Enforcement of the securities laws is the largest activity at the SEC. It accounts for a third of the Commission's total budget - which is justified by egregious examples of fraud; market manipulation; insider trading; and efforts by organized criminal elements to launder funds through the securities industry.

The Equity Fundings, Robert Vescos and Gary Llewelyns of this world, victimize scores of companies and thousands of investors annually.

In bull markets, bucket shops spring up like mushrooms.

When "hot new issue" markets collapse, investors sustain huge losses. This is particularly true of highly promotional offerings of start-ups, sold to unsophisticated investors. Such offerings account for a very small percentage of the total dollar volume of new issues, but they do great harm to public confidence in the securities markets.

During recessions, such as last year, some companies temporize with bad news - or delay its disclosure. And announcements of tender offers - at large premiums over the market - are often preceded by insider purchases.

The SEC is coming down hard on egregious offenders. On the other hand, legitimate businesses and securities firms should not be prosecuted through publication of unproven charges in the press; nor burdened with excessive regulations.

#### Recent Developments at the SEC

The SEC has initiated programs which are saving securities firms, corporations and the investing public hundreds of millions of dollars per annum, and reducing the Commission's paperwork, but not investor protections.

#### Integration

For example, as you know, last year the Commission integrated publicly-owned corporations' registration and reporting requirements - under the multiple securities laws and regulations. Integration is one of the most important improvements in the securities laws, since they were enacted - half a century ago. It has increased corporation's financing flexibility and reduced their expenses (for the benefit of their shareholders) by well over \$350 million per annum, as well as the Commission's paperwork, but not the full and timely disclosure of material information to the investing public.

#### Net Capital Rule

Over \$700 million of the securities industry's capital has been freed-up:

- o by updating the net capital requirements, to take into account the industry's improved financial and operational conditions;
- o and by permitting the use of letters of credit for clearing-house deposits and stock loan collateral.

This additional capital is helping the industry handle the record volume of securities transactions and financings, and improve other services to investors and corporations.

### Institutional Delivery System

Additional savings to brokers and agent banks - of over \$400 million per annum - are expected from the recently approved, book entry delivery system for institutional trades.

### Registration Exemptions

For the benefit of small businesses, the Commission has exempted from registration, certain securities offerings - up to \$5 million to others than the general public. The exemptions for private placements with institutions and other sophisticated investors have also been simplified and improved.

Financings under these additional exemptions are expected to exceed \$20 billion this year. Most states are expected to adopt comparable exemptions - which will be the first, joint state and federal registration exemptions.

### Shelf Rule

As you know, the shelf registration rule - which the SEC adopted on a temporary basis last year - permits corporations to file a single registration statement covering securities they expect to sell from time to time within two years. Contrary to some press reports, it does not relieve corporations of their obligation to keep investors informed of material interim developments. Corporations have to make such disclosures on a timely basis, whether or not they have filed a registration statement with the SEC.

In addition to traditional shelf filings, such as employee stock purchase plans, about \$75 billion of investment grade debt and \$10 billion of equities have been registered under the shelf rule, since March of last year. About half of these offerings have come to market.

The effects of the shelf rule on investors, issuers, the securities industry and markets, are being carefully analyzed. Next month, the Commission will determine whether to extend, modify or withdraw the shelf rule.

### SEC/CFTC Accord

The Accord concluded with the Commodity Futures Trading Commission, resolved a seven-year turf battle between the SEC and the CFTC. This Accord has permitted the SEC to authorize trading in options on Treasuries, GNMMAs, foreign currencies, certificates of deposit and stock indices.

Some of these new options have been endorsed by the Federal Reserve, the Treasury, the housing, banking and securities industries. They are facilitating government and mortgage financings, international trade - and hedging the risks of fluctuating interest rates and securities markets.

#### Swiss Accord

The Accord concluded with Switzerland, removed the haven of the Swiss Secrecy Laws from those who would trade on inside information. During this period of increasing internationalization of the securities markets, the Swiss accord is an important precedent.

#### Proxies and Communications

The proxy and shareholder communication rules and investment company prospectuses have also been simplified and improved.

#### Self-Regulation

Self-regulation by the securities industry and the accounting profession, under the SEC's oversight, is also being enhanced. Effective self-regulation by the NASD and the stock exchanges is more efficient and far preferable to state and federal regulation. With the rapid growth of the securities markets, it is, therefore, essential that securities firms and the self regulatory organizations continue to upgrade their surveillance activities in order to maintain the public's confidence in the industry's high standards of business conduct. Unscrupulous salesmen - who churn accounts and sell unsophisticated investors unsuitable securities - impugn the integrity and reputation of their firms, the industry and all of us.

In the accounting area, the 428 firms - which audit over 90% of the 9,000 publicly-owned corporations - are on a three-year peer review cycle. The purpose of these reviews is to assure high auditing standards. They "pay for themselves" by reducing accounting firms' exposure to liabilities to those who rely on their audits.

#### Market Surveillance

In addition, the stock exchanges and the NASD are enhancing their electronic inter-market surveillance systems and transaction audit trails. These measures facilitate the quick identification of market manipulation and insider trading. They also reduce the industry's transaction reconciliation costs.

### National Market System

With reference to the national market system, by next February, last sales in over 700 national market system NASDAQ stocks will be electronically reported throughout the country, as they are executed -- and the NYSE is conducting a pilot operation, known as R-4, Registered Representative Rapid Response, which permits derivatively priced, instant executions of small orders by account executives.

There is no evidence to date that the experimental linkage of the exchange and over-the-markets in 30 stocks, has improved or hurt the markets in these stocks. Most of the off-board market makers have dropped out of this market. The Commission has, therefore, deferred action on an order exposure rule.

### Conferences

In a related area, the Commission is spending more time listening and responding to the needs and interests of investors, securities firms, corporations and others.

Within the past 12 months, the Commission has received the recommendations of the SEC Advisory Committee on Tender Offers and has held:

- o the first Research Forum at which leading securities analysts recommended improvements in the SEC's disclosure and rulemaking practices;
- o the first round of meetings with other agencies with which the SEC has overlapping jurisdiction - the Federal Reserve Board, the Comptroller of the Currency, the FDIC, the Federal Home Loan Bank Board, the Commodity Futures Trading Commission - it's a long list;
- o the first Government-Business Forums on Small Business Capital Formation;
- o an international conference with securities regulators from over 30 nations;
- o and a conference on major issues confronting the securities markets in the 1980s.

These and other efforts are resulting in important administrative and legislative initiatives.

### Task Force

By way of one example, the laws that govern the securities, banking, savings and loan and insurance industries are the product of the depression - half a century ago. They addressed a different era and different problems than those the nation confronts today. Our present regulatory structures are based on historical industry classifications, but major mergers and acquisitions and new products and services - such as the money market funds and dozens of others - have bridged the traditional gaps between these industries.

Regulatory overlaps and conflicts have also multiplied. Today, 10 federal and over 100 state agencies regulate various aspects of the securities markets alone.

In addition, some financial products and services compete on the basis of their regulatory classifications, rather than their economic merits.

Shortly after arriving at the SEC 2 1/2 years ago, I began advocating - in Congressional testimony and speeches - the formation of a task force to help simplify and rationalize the regulatory structures of the financial service industries. Specifically,

- o regulation by functional activities, rather than by outmoded industry classifications;
- o consolidation of overlapping and duplicative regulatory activities;
- o and elimination of excessive regulations within and between agencies.

In January, such a task force was formed by Vice President Bush. It is expected to propose major legislative initiatives later this year.

### Conclusion

In conclusion, the regulatory structures of the financial service industries are lagging far behind the accelerating rate of growth and change in the marketplace. They are burdensome and no longer responsive to many of the problems and opportunities of the balance of this century.

However, the issues are being identified and addressed by the NSTA, the SIA, the NASD and the securities exchanges, as well as by the SEC, the Bush Task Force, the Administration and Congress.

Major steps have been taken for the benefit of investors, the securities industry and corporate issuers. More are in prospect. So, like Merrill Lynch, I am bullish on the prospects for the securities industry, the economy and the nation.

Thank you.