

STATEMENT OF JOHN S.R. SHAD,  
CHAIRMAN OF THE SECURITIES AND EXCHANGE COMMISSION,  
TO THE SUBCOMMITTEE ON TELECOMMUNICATIONS, CONSUMER  
PROTECTION, AND FINANCE OF THE HOUSE  
COMMITTEE ON ENERGY AND COMMERCE

March 21, 1985

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Chairman Wirth and Members of the Subcommittee:

The Securities and Exchange Commission appreciates this opportunity to present an overview of its fiscal 1984 activities and ongoing efforts. A separate statement setting forth the Commission's authorization request for 1986-88 has also been submitted. It is requested that these statements be made part of the record.

The Commission requests a three-year authorization for appropriations in the amounts of \$113.6 million for fiscal 1986, \$116.0 million for fiscal 1987, and \$121.8 million for fiscal 1988.

The Commission's Fiftieth Annual Report, transmitted to Congress in January, provides an extensive explanation of the Commission's activities in fiscal 1984. The following briefly highlights the Commission's 1984 results and its ongoing efforts.

I. OVERVIEW OF FISCAL 1984 RESULTS AND ONGOING EFFORTS

Investor protections and corporations' financing flexibility were increased, and unnecessary paperwork and other expenses, ultimately borne by investors, were reduced.

Through automation, paperwork reduction and other staff initiatives, record results (or the highest levels in years)

were achieved in the volume and efficacy of enforcement actions, investment company and adviser inspections, broker-dealer oversight examinations and reports processed, self-regulatory organization inspections, full disclosure filings processed, and appellate and other cases opened. Since fiscal 1981, the annual volume of these activities has been increased by 19% to 78%, with 5% less personnel. Also, the 1981-84 average annual rate of accounting firm peer reviews, under SEC oversight, has been increased more than 100% over the 1978-80 rate.

Summary of Activities  
Securities and Exchange Commission:

<u>SEC Fiscal Years Ended Sept. 30th</u>	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1981-4</u> <u>Change</u>
Investment Co. & Adviser Inspections	748	1,065	1,085	1,335*	+78%
SRO** Inspections	12	19	18	20*	+67%
Appellate and Other Cases	102	115	143	167*	+64%
Enforcement Actions Brought	191	254	261	299*	+57%
Broker-Dealer Oversight Examinations	278	249	324	389*	+40%
Broker-Dealer Reports Processed	6,106	6,599	7,067	8,290*	+36%
Full Disclosure Filings Processed	56,919	63,423	65,550	67,466*	+19%
Staff-Years	1,982	1,881	1,921	1,885	- 5%
Fees as a Percent of Budget	81%	94%	110%	129%*	

\* A record or the highest level in years.

\*\* Self-Regulatory Organization.

A. Edgar

The pilot high-speed electronic disclosure system ("Edgar") was commenced on schedule. It is intended to accelerate dramatically the filing, processing, dissemination and analysis of corporate information; revolutionize the manner in which many investment decisions are made and executed; and contribute to the efficiency of the securities markets.

As corporate information is filed with the Commission, it is intended to afford investors, security analysts and others, instant access to it on home and office computer screens. Edgar will also save time and errors by eliminating the frequent need to transfer data manually from one format to another; and will enable the Commission's staff to process filings more efficiently. Full scale implementation of Edgar is intended to coordinate with the rapid growth of home computers -- from 16 million today to twice that many in less than five years.

The pilot system accepted its first electronic filing on September 24, 1984. Through February, 466 filings have been received from 144 issuers. They range from General Motors, Exxon, IBM and other major industrial, utility and financial corporations to small limited partnerships. The filings include annual and interim reports, proxy and registration statements, post-effective amendments and other forms. They are filed directly, over telephone lines, on diskettes and magnetic tapes. Public access to the pilot filings is available through terminals in the Commission's Washington, Chicago and New York Public Reference Rooms. Computer generated microfiche is produced overnight, which is two weeks faster than for paper filings.

Staff reviews are also faster because information is available instantly at work stations, rather than through manual delivery of microfiche or paper copies; and the staff has immediate access to external data-bases, which expedites research of complex legal, accounting and other matters.

The benefits to issuers are that their filings are received, processed and disseminated faster. General Motors Acceptance Corporation has indicated that Edgar has enabled them to respond rapidly to changing market conditions and get to the market faster. Electronic mail and fee payment capabilities have been added; and the Commission is experimenting with image processing and encryption devices. Edgar filings will also be simultaneously transmitted to all the state securities commissions, the securities exchanges and the National Association of Securities Dealers, Inc. California, Georgia and Wisconsin are already receiving Edgar filings.

Additional pilot projects underway within the Commission, include the use of computer work stations by:

- ° the Investment Management Division for investment company and public utility filings, and to review investment company and adviser inspection reports;
- ° the Enforcement Division to analyze trading patterns, mark-ups and mark-downs; and
- ° the Chicago Regional Office to support enforcement investigations and process small issuer filings.

The Commission is proceeding with a view to phasing all SEC registrants into a fully integrated system beginning in 1986 and ending in 1988.

Telecommunication technology has already had a dramatic impact on the domestic and international securities markets. It has permitted global trading in world class securities; high-speed electronic execution and confirmation of the record

volumes of securities transactions and financings; and multi-million dollar savings, through the use of electronic book-entry delivery systems. Edgar is the next step. It has the potential to improve the manner in which investment decisions are made and executed, and the efficiency and fairness of the securities markets.

B. Enforcement

The 299 enforcement actions initiated in fiscal 1984 involved 128 cases alleging misconduct by broker-dealers, investment advisers and other regulated entities; 48 cases alleging failure to register securities offerings; 36 cases alleging issuer fraud and reporting violations; 33 cases alleging financial disclosure violations by issuers and their employees; 18 cases alleging misconduct by accounting firms, their partners and employees; 13 cases alleging insider trading; 12 cases alleging market manipulation; and 11 cases arising out of changes in corporate control.

C. Insider Trading Sanctions Act

The Commission proposed this Act, which was signed by the President in August. Most inside traders have only been compelled to disgorge their profits, which has not been much of a deterrent. Now they will be subject to fines, up to three times their profits. Criminal fines for violations of the securities laws were also increased -- from the \$10,000 established 50 years ago, to \$100,000 per count.

D. Revised Shelf Registration Rule

This rule has increased the largest and most creditworthy corporations' financing flexibility and reduced their expenses, for the benefit of their shareholders, by hundreds of millions of dollars per annum, without compromising full disclosures. These large savings are principally due to keener competition among underwriters, and among institutions which purchase the bulk of such issues, whether under shelf or conventional offerings. The Commission is continuing to monitor the effects of the rule and will take appropriate action, if warranted.

E. Proxies and Mutual Fund Prospectuses

Simplification and improvement of these documents have reduced their cost and increased their utility to investors.

F. New Options

As a result of Congressional action implementing the SEC/CFTC Accord, new options and futures permit investors and corporations to hedge stock market, foreign currency and other risks at a fraction of the cost of prior means of hedging or reducing such risks.

G. Intermarket Surveillance

At the Commission's initiative, the exchanges are installing electronic intermarket stock and options surveillance systems and transaction audit trails for the quick identification of inside traders and market manipulators. Audit trails also reduce transaction reconciliation costs, ultimately borne by investors.



H. Budget

Registration, transfer and other fees collected by the Commission exceeded its budget by 29%. In the past two fiscal years, such fees have exceeded the Commission's budget by over \$35 million.

I. Shareholder Communications

Rules proposed by the Commission in 1984 will telescope the time and expense of corporations' communications with their shareholders, by requiring brokers to provide corporations with the identity of those shareholders, who do not object. Legislation proposed by the SEC would authorize the Commission to adopt similar rules for banks. The Commission continues to support this legislation and requests that Congress act on it during this Session.

J. Bush Task Group

The recommendations of Vice President Bush's Task Group on Regulation of Financial Services include consolidation within the SEC of the filings of all publicly owned banks and thrifts and other major legislative initiatives for the benefit of investors and depositors. The Commission supports the Task Group's recommendations.

K. Foreign Investment Companies

In January of 1984 the Commission recommended that the Investment Company Act of 1940 be amended to make it easier for the Commission to permit an operating foreign investment company

to register under the Act and sell its shares in the United States when the Commission finds this to be consistent with the purposes of the Act and the protection of investors. The Commission recommends that Congress consider this proposal.

L. SIPA Amendments

The Securities Investor Protection Corporation ("SIPC") has proposed legislation, which Chairman Dingell has introduced, to amend the Securities Investor Protection Act of 1970 ("SIPA") in order to preserve the jurisdiction of bankruptcy judges over SIPC liquidations of insolvent broker-dealers and to make other changes in SIPC liquidation procedures. The Commission supports these objectives.

M. Technical Amendments

In 1983 at the request of Chairman Wirth the Commission proposed the Securities Law Technical Amendments Act, which would have made various technical changes and conforming amendments in the federal securities laws. The Commission requests that Congress consider a similar technical amendments bill during this Session.

N. Conclusion

The 50th Anniversary year results are a tribute to the Commissioners and the fine men and women who serve throughout the agency. In addition to ongoing programs, the future offers the prospect of major improvements in the regulatory structures of the financial service industries and the exciting

potential of high speed electronic dissemination and analysis of corporate information.

## II. DISCUSSION

### A. Budget Authorization for Fiscal Years 1986-1988

The Commission seeks authorization for appropriations in the amounts of \$113.6 million in fiscal 1986, \$116 million in fiscal 1987, and \$121.8 million in fiscal 1988, in order to cover rising costs, to implement prospective legislation, and to upgrade the Commission's mainframe computer.

The Glass-Steagall Act amendments and the recommendations of the Bush Task Group on Regulation of Financial Services, permitting banks to underwrite municipal revenue bonds and mortgage-backed securities and to sponsor and distribute mutual funds and requiring publicly-owned banks and thrifts to file with the SEC, would significantly increase the number of broker-dealers and investment companies subject to SEC supervision, and the volume of filings with the SEC. Additional staff will be required to review and comment on these filings and requests for interpretations, to conduct cause and oversight examinations, and to enforce the securities laws.

Personnel expenses for the Commission's current staff will rise appreciably due to federal pay increases projected by OMB for fiscal 1987 and 1988. Additional costs would be generated by mandatory merit payouts, within-grade increases,

and the need to annualize the salaries of new staff. Non-personnel expenses will rise due to inflation and the need to upgrade the Commission's mainframe computer.

The three-year authorization is needed to strengthen the Commission's ability to fulfill its mandate. Ensuring investor protections, facilitating capital formation, and accommodating market changes are goals requiring long-range planning and multi-year commitments. Projects designed to reach these goals, such as the electronic disclosure system and the productivity improvement programs, are multi-year efforts. A three-year authorization is needed to define the fiscal parameters within which the Commission can implement these projects and its ongoing efforts.

B. Legislative Proposals

1. Bush Task Group Recommendations

During the past four years, in Congressional testimony, speeches and discussions with the chairmen of the House and Senate committees concerned, the Commission has recommended that financial services be regulated by functional activities, rather than by outmoded industry classification; that overlapping, duplicative, and conflicting regulatory activities be consolidated; that excessive regulations within and between agencies be eliminated; and that a one-year task group be formed to refine and assist Congress in the implementation of such concepts.

The Commission participated in the Bush Task Group, which has made such recommendations. The main proposals affecting the Commission would repeal the exemptions in the Securities Act of 1933 for registration of securities issued by banks and savings and loan associations and would consolidate, within the Commission, administration of the periodic reporting, proxy solicitation and short-swing profits provisions of the Securities Exchange Act of 1934 as they relate to such institutions. The Federal Reserve Board, the Comptroller of the Currency, the Federal Deposit Insurance Corporation and the Federal Home Loan Bank Board presently administer such regulations for different categories of banks and thrift institutions. The SEC administers such regulations for all other publicly-owned corporations, as well as for bank and thrift holding companies. Consolidation within the SEC will permit more uniform and efficient administration and enforcement of these disclosure and other requirements.

The Task Group recommendations also include amendments of the Securities Act to broaden the authority of the Commission to grant exemptions from registration deemed to be in the public interest; exempt from registration securities issued in connection with conversions of banks into holding companies, where the security holders will have substantially the same rights and interests as before; repeal the Public Utility Holding Company Act; and implement other measures intended to simplify improve and increase the cost-effectiveness of the regulation of the securities, banking and thrift industries.

## 2. Shareholder Communications

Last year the Commission proposed legislation that would amend Section 14(b) of the Exchange Act to authorize the Commission to regulate the dissemination of proxy materials by banks, associations and other entities in the same fashion as the Commission now regulates the dissemination of proxy materials by broker-dealers. It was introduced in both houses of Congress and was added to the Tender Offer Reform Act by the House Committee on Energy and Commerce. The Commission continues to support this legislation and requests that Congress act on it during this Session.

This legislation would permit the Commission to adopt regulations, similar to those that will become effective January 1, 1986 for broker-dealers, to require that banks provide corporate issuers with the identity of their shareholders who do not object.

## 3. Foreign Investment Companies

Section 7(d) of the Investment Company Act currently prohibits a foreign investment company from offering its shares in the United States unless the Commission issues an order permitting it to register under the Act and to make such an offering. Section 7(d) requires that the Commission make certain findings before issuing such an order that cannot be made in the case of most foreign investment companies. As a result, foreign companies are denied access to American

capital markets, and American investors are denied the opportunity to make such investments.

In February of 1984 the Commission recommended that the Act be amended to make it easier for the Commission to permit an operating foreign investment company to register under the Act and sell its shares in the United States when the Commission finds this to be consistent with the purposes of the Act and the protection of investors. The Commission recommends that Congress consider this proposal.

#### 4. SIPA Amendments

The Securities Investor Protection Corporation has proposed legislation, which Chairman Dingell introduced on February 28, to amend the Securities Investor Protection Act in order to preserve the jurisdiction of bankruptcy judges over SIPC liquidations of insolvent broker-dealers. The Bankruptcy Amendments and Federal Judgeship Act of 1984 permits a party to seek to have a particular proceeding relating to customer claims decided by a district court judge rather than by a bankruptcy judge, resulting in possible bifurcation of SIPA proceedings. The proposed SIPA amendments are intended to assure that bankruptcy judges generally would decide these customer claims.

In addition, the amendments would give SIPC an automatic right to participate in related state court proceedings. This is important because the bankruptcy amendments encourage

the abstention of federal district courts on state law claims or causes of action related to bankruptcy cases. Finally, the proposed amendments would change existing law relating to the manner in which aggrieved customers can obtain judicial review of determinations in direct payment proceedings under SIPA. The amendments would permit only district court judges, rather than bankruptcy judges, to review these determinations.

The Commission supports these objectives.

#### 5. Technical Amendments

In 1983 the Commission proposed the Securities Law Technical Amendments Act to make technical, clarifying, and conforming amendments to the securities laws. The bill, introduced as H.R. 4574 of the 98th Congress, was sponsored by Chairman Wirth and co-sponsored by Chairman Dingell. The Commission staff prepared the bill after Chairman Wirth requested legislative proposals to eliminate anomalous and outmoded provisions of the securities laws during the Commission's authorization hearing on February 15, 1983.

The Commission is now proposing a similar technical amendments bill, the Securities Law Technical Amendments Act of 1985. The Commission believes that all of the proposals in the new bill are noncontroversial. The great majority are technical corrections eliminating typographical errors and obsolete and ineffective provisions. For the most part, the



provisions are identical to those found in H.R. 4574. The bill's more substantive provisions include the following:

First, Section 105, which was contained in H.R. 4574, would eliminate a possible form of discrimination against savings and loans as compared to banks, by deleting the condition applicable to savings and loan associations that, for their securities to be exempt from registration, they not change certain entry fees.

Second, Section 209, which was also included in H.R. 4574, would give the Commission authority to decline to accept payment of fees in cash, thereby reducing security problems and eliminating the need for separate accounting records.

Third, Sections 219(1) and (2), 509, and 602(1), (2), and (3), which are new, would permit the Commission to impose administrative sanctions on persons already within its jurisdiction for misconduct relating to transfer agent activities. These amendments also would substantially conform the disqualification and sanction provisions in the Investment Company and Investment Advisers Acts to those in the Exchange Act. This would permit the Commission to impose administrative sanctions for misconduct arising out of activities in the municipal securities and commodities markets on investment advisers and persons associated with investment advisers, as well as on the management of investment companies. In a similar vein, Section 221 would conform the sanctioning provisions applicable to municipal securities

professionals to those applicable to other securities professionals by authorizing the Commission to "place limitations" on the activities of municipal securities professionals.

Fourth, Section 223, which was included in H.R. 4574, provides for self-regulatory organization access to the complete results of fingerprint identification processing.

Fifth, Section 224, which is new, would expand authority of the Commission and the federal bank regulatory agencies that regulate transfer agents in three primary ways. First, the agencies would be authorized to bring administrative proceedings against professionals associated with the transfer agents they regulate. Second, it would expand the grounds for sanctioning transfer agents in administrative proceedings to include convictions and injunctions relating to financial services industry activities and violations of the securities laws in addition to Section 17 and 17A of the Exchange Act. At present, the grounds for imposing administrative sanctions on transfer agents include only violations of, or inability to comply with, Sections 17 and 17A and the rules thereunder, which relate to recordkeeping and clearing and settling securities transactions. Third, Section 224 would allow the agencies to bring administrative proceedings against a transfer agent for acts of professionals associated with the transfer agent.

The Commission recommends that Congress give favorable consideration to this legislation.