

MEMORANDUM

TO: Senator William Proxmire
FR: Steven B. Harris and William T. Dehnke
SUBJECT: Bevis Longstreth Article, "Putting Reins on Wall Street"
DATE: July 10, 1987

Below is a quickly put together memorandum regarding Bevis Longstreth's New York Times article, "Putting Reins on Wall Street". It is written in a fashion that might be converted to a letter to the Editor or a floor statement.

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In his July 9, 1987 article "Putting the Reins on Wall St." former SEC Commissioner Bevis Longstreth made three recommendations for better regulation of the securities industry: (1) Increased funding for the SEC; (2) stiffer penalties for violations of the securities laws, and; (3) a strengthening of the Chinese Walls in multiservice investment firms. Mr. Longstreth's recommendations are well considered and largely parallel the advice reaching Congress from a number of other sources. In responding to these concerns, Congress has already taken these actions:

On June 24, 1987 the Senate Banking Committee approved a budget authorization for 1988 for the SEC which included the entire amount requested by the agency--plus a restoration of the funds cut by the Administration from the SEC's proposed budget

before the agency was even allowed to send its request to the Committee. This will result in an increase of over 30% from the 1987 budget level and constitutes a long overdue increase in resources for the agency. The budget level approved will provide significant additional resources to the agency's enforcement and anti-fraud programs.

This budget authorization was developed under the leadership of Senator Donald W. Riegle, Jr. as Chairman of the Securities Subcommittee. Two sets of Subcommittee hearings earlier this year on the adequacy of the SEC's resources lead to the conclusion that the growth of the agency has been deliberately restrained by the Administration since 1980, while the securities industry experienced a simultaneous period of unprecedented growth in volume and complexity. Mr. Longstreth is quite correct in pointing out that the SEC's resources have, effectively, been held constant for the past several years in the face of an explosion of activity in the regulatory environment. Several witnesses from the securities industry advised the Subcommittee this year that they would support increases of up to 100% in the agency's budget and they stressed the critical role of the SEC in maintaining investor confidence in market integrity.

This past restraint in funding the SEC is even more curious when viewed with the knowledge that the agency collected fees in an amount exceeding its budget by over 100% last year alone. In other words, the SEC is, in effect, a self-funding agency which does not require tax dollars to carry out its functions and which

has not been permitted by the Administration to use the revenue generated from increased securities activities to fill the expanded regulatory demand. As Mr. Longstreth noted, it is inescapable to conclude that the resource restraints on the SEC probably contributed to the recent scandals in the industry. The budget authorization recently adopted by the Senate Banking Committee is intended to provide overdue assistance in bringing the SEC's resources back into pace with the industry.

Concerning Mr. Longstreth's second recommendation for stiffer penalties for violations of securities laws, I again concur completely. The courts should impose stiffer penalties under available law for these crimes and, in addition, I have introduced legislation providing for tougher statutory penalties. This provision, now under consideration by the Senate Banking Committee, would permit criminal fines of up to \$1,000,000 and imprisonment of up to 10 years for any willful insider trading. The bill would also provide for an additional one year sentence for intentional obstructions of justice and perjury in connection with any investigation of any alleged insider trading.

Finally, Mr. Longstreth's third recommendation regarding a strengthening of the Chinese Wall concept at multiservice investment firms is also timely and well founded. Proposed legislation now before the Senate Banking Committee on insider trading has been drafted to provide strong incentives to such multiservice firms to re-examine and strengthen their internal procedures to prevent the flow of information between departments.

The provision under consideration would allow an investment firm to present evidence that reasonable Chinese Wall procedures were in place in order to avoid liability for alleged insider trading under appropriate circumstances. By raising the Chinese Wall issue in this context, the proposed legislation provides a strong incentive for all multiservice investment firms to redouble their own internal control efforts as insurance against the potential enormous liability for insider trading violations.

While I agree with Mr. Longstreth's three specific recommendations I think he is overdramatic in his statement about the potential effects of certain legislative initiatives in the securities business. He says that "we do not need new regulations to restrict takeover bids". Sixty-seven percent of the American people, as surveyed in a recent Lou Harris poll disagree.

What are some of the issues that are under consideration?

1. Closing the section 13(d) window to prohibit a raider from continuing to acquire stock above a certain threshold without disclosing that fact to the public.
2. Extending and clarifying the definition of a "group" to restrict the type of manipulative practices we are currently witnessing.
3. Increasing the penalties for failing to file, or improperly filing, certain documents which are now required to be filed under law with the Securities and Exchange Commission.
4. Requiring that acquisitions of more than a certain percentage of a company's stock be made by tender offer.

5. Prohibiting greenmail without prior shareholder approval. Greenmail is that practice whereby a financial entrepreneur can blackmail a corporation into buying him out at an exorbitant price not available to all other shareholders.

Both the investment banking community and the business community agree that each of these issues should be addressed in legislation. Groups which support addressing these issues include the Business Roundtable, the National Association of Manufacturers, Stakeholders in America, the Securities Industry Association, and the Capital Markets Group which represents First Boston Corporation, Goldman Sachs and Morgan Stanley.

I would go farther to provide greater fairness to all shareholder and to increase the disclosure of material information to the marketplace. But I find it peculiar that Mr. Longstreth would not go even this far.

With respect to efforts underway in the Congress to clarify the law on insider trading I plan to reserve judgement until after I have seen the final legislative package that is being developed by the Chairman of the Securities Subcommittee, Senator Donald W. Riegle, Jr. But I applaud his efforts in this area. Why do we need a definition of insider trading when the law seems to be working perfectly well and so many people are being hauled off to jail for violating it? There are a number of responses. First, the government has suffered recent setbacks in the Supreme Court and certain of its key prosecutorial theories are currently being challenged. Second, we deserve clarity in our laws, and the law on insider trading is poorly understood. And third,

securities industry groups such as the Securities Industry Association and the Capital Markets Group as well as government prosecutors such as Rudolph Giuliani and former SEC Division of Enforcement Director Judge Stanley Sporkin, have called for a clarification of the laws.

The securities industry itself has argued that "The current law of 'insider trading' is at best confusing and at worst ineffective in prohibiting the misuse of confidential information in trading in our national securities markets. The 'insider trading' law has been developed by the courts under general antifraud provisions. There is currently no statute which deals specifically with the subject of misuse of information in trading."

... They recommend that "A special statute should be enacted separate and apart from the general antifraud provisions of the federal securities laws, to deal with the subject of trading on the basis of nonpublic information. The details of the statute should be worked out by securities professionals, who are familiar with the workings of the securities industry and who understand how to craft a statute which will not interfere with healthy and desirable market activity."

That is exactly the approach being taken by the Banking Committee's Securities Subcommittee.

So who recommends putting reins on Wall Street? A whole lot of people including the securities industry. But clearly not Mr. Longstreth.