

For Chairman's Remarks Before the
Federal Regulation of Securities Committee
of the American Bar Association

"The First 105 Days"

Washington, D.C.
November 20, 1987

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Testimony Before the Subcommittee on
Telecommunications and Finance of the
House Committee on Energy and Commerce
-- Concerning the Structure and Regulation
of the Financial Services Industry

On October 5, 1987, I testified before the House Subcommittee on Telecommunications and Finance concerning the structure and regulation of the financial services industry. I expressed my belief that banks that engage in the securities business should be subject to functional regulation. I stated my support for the proposed "Bank Broker-Dealer Act of 1987," which would require that banks engaging in broker-dealer activities do so through separate affiliates subject to Commission regulation, and my support for the Bush Task Group recommendations to consolidate in the Commission administration and enforcement of these securities registration and reporting requirements for all publicly-owned banks and thrifts.

In short, if banks are permitted to engage in securities activities they should be permitted to do so only in separate affiliates subject to Commission regulation.

At the request of the House Subcommittee on Telecommunications and Finance, the Commission staff currently is preparing a report examining the possible effects on investor protection, among other things, of repealing the Glass-Steagall Act. The Senate Committee on Banking, Housing, and Urban Affairs will soon hold hearings regarding Glass-Steagall repeal. Earlier today, two versions of proposed financial restructuring

legislation were introduced in the Senate. Senators Proxmire and Garn introduced the "Financial Modernization Act" (S. 1886). Senators Graham and Wirth introduced the "Financial Services Oversight Act." Commission testimony regarding these bills is scheduled for December 3, 1987.

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"Black Monday" and the October Market Break

On "Black Monday," October 19th, the Dow dropped 508 points. This dramatic decline followed two weeks in which the Dow dropped a total of 393 points. Later in the week which began with Black Monday, the Dow rose 120 and then 189 points during two consecutive days. The volatile decreases and increases in stock prices during the past weeks have been accompanied by unprecedented volume.

The Commission has been active in its oversight of the operational and financial integrity of the markets during the past weeks, and it presently is engaged in examining fundamental questions which have been raised regarding the operation of our market system. In particular, I have asked the staff to investigate causes and effects of extreme volatility. Among the issues to be addressed by our study will be the role of index-related trading in the markets during this period. The study also will cover other questions raised by these events, including the adequacy of dealer capital during periods of increased volume and volatility, and the adequacy of the financial integrity regulations governing broker-dealers. Additionally, the study will examine the market's operational capacity for order execution, order routing and clearance functions. We will also study the relationships between the various foreign and domestic markets during this time.

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Legislation to Define Insider Trading

Yesterday, the Commission released a letter to the Senate Subcommittee on Securities transmitting the Commission's proposed legislation to define and prohibit insider trading. The Commission had submitted its original proposal to the Subcommittee on August 3, in connection with Subcommittee hearings on S. 1380, insider trading legislation drafted by an Ad Hoc Legislative Committee chaired by Harvey Pitt and introduced by Senators Riegle and D'Amato. I believe the Commission has adopted a legislative proposal that will protect the securities markets against misuse of confidential information and will further the Commission's enforcement program. We are pleased to have worked cooperatively with Senator Riegle, Senator D'Amato, and the Ad Hoc Legislative Committee to achieve a positive result.

At the request of Senator Riegle and Senator D'Amato, representatives of the Commission and the Ad Hoc Committee met to assist the Subcommittee in its efforts to develop a consensus proposal for legislation. Following extensive discussions with the Ad Hoc Committee representatives and further Commission deliberation, the Commission has submitted revised legislation defining insider trading that it has approved, provided certain interpretive issues are properly resolved in its accompanying legislative history.

The Commission's proposal would prohibit persons from trading, or causing trading of, any security while in possession of material nonpublic information where they know or recklessly disregard that the information has been "obtained wrongfully" or that the trade would constitute a "wrongful use" of the information. This would occur if the information has been obtained by or its use would constitute (A) theft, bribery, misrepresentation or espionage or (B) conversion, misappropriation, breach of any other fiduciary duty or breach of other relationships. Under the proposal, such persons would also be prohibited from "wrongfully communicat[ing]" information they know or recklessly disregard is material and nonpublic to others where subsequent trades are reasonably foreseeable. The definition of wrongful communication, in this context, is analogous to the definition of "wrongful use" in the trading prohibition. In addition, the proposal would codify the substance of existing law governing tipping and trading while in possession of material nonpublic information relating to a tender offer.

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The Commission's proposal includes express private rights of action for contemporaneous traders and for other persons who are injured by violations of its provisions in connection with their securities trading. The proposal also would provide the Commission with broad authority to exempt any persons, securities

or transactions from any or all of its provisions, and would make certain conforming amendments to the Insider Trading Sanctions Act.

Agreement with Pitt Committee exact

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Enforcement Matters

In the past three months, the Commission has conducted more than a dozen closed meetings to consider enforcement matters. During this period, we have authorized 20 formal investigations, 36 administrative proceedings, and 33 civil injunctive actions. Additionally, the Commission has approved and issued five opinions on appeal from SRO disciplinary proceedings or from rulings of administrative law judges.

During the course of the Commission's deliberations on enforcement matters, we have considered a wide variety of alleged violations. For example, we have considered matters involving: insider trading; manipulation; financial fraud; delinquent filings; violations of the reporting, recordkeeping, and internal accounting controls provisions; unregistered offerings; unregistered broker-dealers; unregistered investment advisers; and staff recommendations for institution of Rule 2(e), criminal contempt, and subpoena enforcement proceedings.

- 4 -- New York Stock Exchange (Birnbaum, Grasso)
[re: 144A]
Treadway & McCoy
- 5 -- "Today Show"
- 6 -- Jim Meyer (NASAA)
- 9 -- Arthur Young, Senior Management
Robert Shlasko (Amex "American Quarterly")
- 10 -- State Department and Swiss Embassy re:
Diplomatic Notes
- 11 -- NIRI Speech
Wall Street Journal Editorial Board
- 12 -- Dorothy Ortiz (presentation of Spanish
dictionary)
Chicago Research and Trading (Joe Ritchie,
Gary Ginter) and Thompson Company (Bob
Thompson, Amanda Stevens)
CFTC Meeting
Nicholas Katzenbach (re: NYSE study)
- 13 -- ACCA Speech
- 16 -- Dr. Maurice Mann, Dale Carlson (Pacific Stock
Exchange)
William Ryrrie, David Gill (International Finance
Corporation); James Hardiman, James Davin
Brian Willott, Undersecretary for Finance (Great
Britain)
- 18 -- Securities Investor Protection Corporation
Joseph Hardiman (NASD)
- 19 -- American Bankers Association (Charlie Pistor, John
Bernhardt, Spencer Eccles, Hans Angermueller, Hugh
Chapman, John Moore, Edward Yingling, James
McLaughlin, Laurie Schaffer)
- 20 -- Jim Cheek
Joe Nicholas
Robert Mundheim
AICPA (Marvin Strait, Ted Barreaux, Phil Chenok,
B.Z. Lee, Bob May)

Staffing Matters

Another area of great importance to me has been, and continues to be, staffing. Upon becoming Chairman, I moved quickly to select my personal staff. More recently, I have been concerned with staffing in the Commission's regional offices (i.e., Atlanta). I should note that I consider relations between the regional offices and the headquarters of the Commission to be of critical importance. Indeed, on Tuesday of this week (Nov. 17, 1987), I attended a conference of the Regional Administrators held in Boston and visited the Boston Regional Office. I already have visited the Chicago Regional Office and intend to visit other regional offices as well.

Strong Staff

Linda Fienberg

visits to Regional Offices

Commission Meetings

Closed:

August 19, 1987
August 25, 1987
August 27, 1987

September 9, 1987
September 10, 1987
September 15, 1987
September 22, 1987
September 30, 1987

October 8, 1987
October 14, 1987
October 22, 1987
October 27, 1987

November 3, 1987
November 10, 1987
November 19, 1987

Total = 15 Closed Meetings

Open (with items, not already mentioned or summarized,
in parentheses):

August 27, 1987 (ML-Lee Acquisition Fund, L.P., et al.)

September 10, 1987 (Middle South Utilities)
September 16, 1987 (Compliance w/'34 Act Section 16(a))
September 30, 1987

October 21, 1987
October 29, 1987 (System Energy Resources; Amendment to
Investment Co. Act Rule 19b-1 re additional
distribution of long-term capital gains;
Exemption from Investment Co. Act for foreign
banks [Rule 6c-9]; Exemption of foreign
government securities under '34 Act for
purposes of futures trading [Rule 3a12-8])

November 5, 1987 (Proposed amendments to Rule 204-2, the
recordkeeping rule under Investment Advisers
Act)

Total = 7 Open Meetings

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National Commission on
Fraudulent Financial Reporting

In October, 1987, the National Commission on Fraudulent Financial Reporting released its report. That report contained significant recommendations to the Securities and Exchange Commission regarding regulation of independent public accountants, corporate governance, Commission enforcement remedies, and other matters. On November 4, 1987, I met with former Commissioner James C. Treadway, Jr. the Chairman of the National Commission on Fraudulent Financial Reporting, to discuss the report, and this afternoon, November 20, 1987, I met with board and staff members of the American Institute of Certified Public Accountants regarding this report.

In the coming months the Commission will be evaluating the recommendations contained in the report, including suggested rule proposals and suggested legislation. ✓

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