SECURITIES AND EXCHANGE COMMISSION HISTORICAL SOCIETY ROUNDTABLE OF SEC CHAIRMEN
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THIRTY YEARS OF CHANGE?
SUBMISSION BY
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Introduction

I came to the Commission in September of 1971 as General Counsel. Bill Casey hired me and convinced me that being General Counsel was the best position short of Chairman. To this day I agree with that conclusion.

When Bill reorganized the Commission by separating Trading & Markets into two divisions: Market Regulation and Enforcement, for the purposes of emphasizing a regulatory approach rather than just enforcement, he asked me to serve as the first Director of the Division of Market Regulation. I remained as General Counsel.

On November 14, 1972, the Dow broke 1000. On February 23, 1973, I was appointed and designated as Chairman and unanimously confirmed March 3rd. On that date, the Dow was 961. A recession was occurring, and the brutal bear market of 1973-74 set in and the Dow went to 577 in December 1974. It would not be until 1976 that the market again went over 1000, and not until late 1982 that the Dow passed 1000 again and stayed. When I left the Commission in May 1973, the Dow was 917.

In 1973, the Commission had 1,500 employees and a $29 million budget. The current budget request is $913 million or 31 X for 30 years and the Commission has 3,060 employees, with an authorization of 3,582 for fiscal 2004.

My remarks and thoughts cover more than just my Chairmanship; they cover my entire tenure at the Commission.

Relationships with Congress and White House

Because the Democrats ran Congress during my tenure, there was always an uneasy relationship between Bill Casey and the Oversight Committees. The ITT matter highlighted this when the Committees requested certain politically sensitive documents Enforcement had gathered as part of its investigation. Bill refused to deliver the documents and asked me to research executive privilege as a means of blocking the request if he were subpoenaed. He arranged for me to meet with John Dean, who he said was an expert on executive privilege. Following that meeting on a Sunday afternoon, which was hardly a scholarly treatment of the issue, I advised Bill that relying on this privilege was tenuous at best, and that if he were subpoenaed, my advice was to comply. I went out of town for a few days, and upon my return asked Bill for an update-he told me that he had shipped all the documents to the Justice Department. As part of my confirmation process, I called upon the Oversight Committees to mend relationships. Harley Staggers from West Virginia confronted me with the ITT matter, and I told him what my advise to Casey had been. He told me that although the exercise had been one of principle, it really didn't matter since the Committee had copies anyway! Still, it made relationships with Congress strained.

My only other contact with the White House staff was shortly after delivering a speech on March15, 1973 to the New York Financial Writers' Association entitled

"The Central Market System: Putting the Markets to Work for the Investor." In that speech, I set forth the central market system concept, which was followed by the release of a white paper on the system on March 29, 1973 The speech caused an uproar, even though the approach suggested was consistent with the Institutional Investor Report of 1971, the recommendations of Bill Martin, the February 2, 1972 Policy Statement and what the Commission had been saying publicly. Wall Street in general, and the New York Stock Exchange in particular ramped up-I got a call from John Erlichman and an invitation to lunch. I was prepared for the worst anticipating interference with the Commission's key initiative. Joining us for lunch was Bill Simon. I will not go into all the details, but the jest of it was: Erlichman said there were some loose cannons (unnamed) on the deck that had to be harnessed, and Simon said the Exchange had had it too good for too many years, so ignore them. He was totally supportive. This is a sanitized version of his comments! In any event, they made no effort to redirect the program.

Commission Openness

When I arrived at the Commission in 1971, former staff members, commissioners and Chairmen walked the halls at 500 North Capitol with impunity. SEC practice was the province of few large Wall Street law firms and some well-placed SEC alumni in Washington. There was a concerted effort to change this-Casey gave 60 speeches in 20 months; the tradition of the SEC Speaks program was initiated in 1972. SEC staff participation in other public programs and conferences was encouraged. In short, the playing field was almost leveled.

As General Counsel, I encouraged the SEC Attorney Fellow Program, and took affirmative action to recruit lawyers from geographical areas outside the East Coast, and made it an accomplished goal to hire the first black lawyer for the office.

Incantations and Theology vs. Objectivity and Regulation vs. Enforcement

Bill Casey ran the Commission as a one-man show. He over powered other Commissioners, and moved his agenda with the help of special assistants brought in to augment or bulldoze the staff.

He reorganized Trading and Markets into two divisions: Enforcement and Market Regulation because he felt that regulation would be stronger if it had its own division.

He appointed Advisory Committees, made up of people from outside the Commission, to review market structure and make recommendations on the Central Market System, enforcement procedures (Well's committee resulted in the Well's Submission); compliance to standardize compliance procedures especially for smaller brokerage houses; Industrial Issuers Advisory Committee making recommendations on annual reports; real estate securities and others. His emphasis was on regulation and as part of that program he pushed the Commission's policy of publishing objective rules and guidelines. There was an attempt to free the securities laws of much of the incantation and theology that had evolved over the years. Examples were the 140 series of rules and release of selective interpretations of Rule 144. Rule 146 was the direct result of the Continental Tobacco case referred to below. I set the stage for white papers on director's responsibilities and insider trading, which were subsequently discarded because it was felt their usefulness would be adversely affected by the complexity of the issues.

In SEC v. Continental Tobacco Company, a case involving a claim for exemption form registration under Section 4(2), we stated in our brief:

"Before the statutory protections may be safely eliminated in any case, the issuer must affirmatively demonstrate by 'explicit, exact' evidence that each person to whom unregistered securities were offered was able to 'fend' for himself-in other words, that each offeree had a relationship to the company tantamount to that of an 'insider' in terms of his ability to know, to understand and to verify for himself all of the relevant facts about the company and its securities."

The 5th Circuit decided the case in our favor. Shortly after this case sunk in with the legal profession, the fact that it made it almost impossible to have an exempt private placement except under the narrowest of circumstances, Rule 146 was put out for comment,

Fixed Commission Rates, Institutional Membershjip on the Exchanges.

The issue of fixed rates and institutional membership were solidly linked. Institutions were seeking exchange membership in order to recapture brokerage commissions on their trades. The New York Stock exchange was bitterly opposed to such membership. Philadelphia was courting the institutions. The Justice Department's Anti-Trust division was opposed to these restrictions. Smaller brokerage firms were complaining that without fixed rates, they would go out of business and research would dry up. Others argued that there were no fixed rates because trades could go to regional exchanges, reciprocals would take place, and other methods were devised to avoid fixed rates-in short for institutions there were no fixed rates. The Commission devised a solution for which I coined the term, "Prudent Gradualism." We would lower the fixed rates from $500,000 to $300,000 to $100,000, thus giving us the opportunity to monitor the effect on the health of the brokerage community. We did lower rates to $300,000 but postponed going to $100,000 because the industry was suffering. But a critical issue remained: who had control over the process-the SEC or private litigants aided by the Justice Department Anti-Trust division.

When I came to the Commission in the fall of 1971, my first Congressional Hearing as General Counsel dealt with this issue and what the Commission's legal authority over rates was-primary jurisdiction, exclusive jurisdiction or none at all. If the later, then the Justice Department would (and was) aggressively move (moving) into anti-trust implications of fixed rates. I had discussions with the head of the anti-trust division on the basis that we would handle this situation, and we didn't need their interference. Thus Rule 19b-2, the result of Harvey Pitt's ingenuity, which limited institutional membership on exchanges to entities that are primarily on the exchanges to do a public brokerage business and to eliminate the kind of institutional membership which merely gave institutions the ability to use the exchanges without paying commissions.

The issue was resolved when fixed commission rates were eliminated.

Central Market System

What was the need to restructure the securities markets in 1973? The markets had been taking a new form at an incredible pace: the surge in institutional trading, the emergence of new markets to handle big blocks of stock, shifts in the pattern of securities trading with the result that for many securities there were many markets-both on the exchanges and off the exchanges in the offices of broker-dealers. The public investor saw only part of the picture. Some of the exchanges displayed all of their trades as they took place, while others displayed some trades but left out others. Markets off the exchanges generally didn't display trades as they occurred. There was uneven regulation of the markets. Some exchanges tried to block their members from taking business off the exchange, while others did not have such barriers. Finally, and perhaps most importantly, there was no communications link really tying these markets together. The solution as proposed was the Central Market System, a communications and regulatory system with three parts: First a network for reporting prices and volume as trades occur so that all the action in a given security can be viewed through a central source, second, a quotation system to capture and display all the bids and offers in these securities so the broker can see where the best price is available and direct the investor's order to it, third, a regulatory framework to assure that the purposes and goals of the system were met. Such a system is still a goal today.

February 1973 General Policy on Earnings Projections-Precursor to Regulation FD.

The Policy was issued after public hearings where 53 witnesses representing the securities industry gave their views. The Commission stated that corporate management should be left with the choice of whether or not publicly to forecast earnings and economic results, and rejected the view that management should be required publicly to disclose its projections. At the same time, the Commission said that once the corporation elects to project earnings to anyone outside the corporation, it must immediately inform the investing public as well. Those companies that elected to issue projections should be required to update them both on a regular basis and in a timely fashion in the event of any material changes and to explain major variations between projections and historical results.

In a speech delivered to the New York Society of Security Analysts in March 1973, I stated:

Any securities market system that is fair requires that both buyer and seller exercise informed judgment. The use of inside information erodes the system by destroying public confidence in our capital markets. It also calls into question the professionalism which is an intrinsic part of any sound investment process.

In recent years, we have seen a number of cases in which inside information is routinely disseminated under the guise of research in exchange for brokerage commissions. We have seen cases where companies trip all over themselves trying to protect friendly analysts from being surprised by a bad earnings report. These companies often wind up passing along to analysts non-public bearish information, which is in turn passed along to institutions, who then go out and clobber the company's stock. We at the Commission have seen too many cases where inside information has been cynically considered by analysts, corporate officials and money mangers simply as coin of the realm.

Compare this quote to the background notes in the final adoption of Regulation FD:

As discussed in the Proposing Release, we have become increasingly concerned about the selective disclosure of material information by issuers. As reflected in recent publicized reports, many issuers are disclosing important nonpublic information, such as advance warnings of earnings results, to securities analysts or selected institutional investors or both, before making full disclosure of the same information to the general public. Where this has happened, those who were privy to the information beforehand were able to make a profit or avoid a loss at the expense of those kept in the dark.

We believe that the practice of selective disclosure leads to a loss of investor confidence in the integrity of our capital markets. Investors who see a security's price change dramatically and only later are given access to the information responsible for that move rightly question whether they are on a level playing field with market insiders.

Issuer selective disclosure bears a close resemblance in this regard to ordinary "tipping" and insider trading. In both cases, a privileged few gain an informational edge -- and the ability to use that edge to profit -- from their superior access to corporate insiders, rather than from their skill, acumen, or diligence. Likewise, selective disclosure has an adverse impact on market integrity that is similar to the adverse impact from illegal insider trading: investors lose confidence in the fairness of the markets when they know that other participants may exploit "unerodable informational advantages" derived not from hard work or insights, but from their access to corporate insiders.

Enforcement Cases

In 1973, the Commission had more major enforcement cases going at the same time than at any other time in the Commission's then history. For example

Equity Funding involved billions of dollars of non-existent insurance policies put on the books (sound familiar?) to create the illusion of dramatic growth. I stated then: "When the stock of a company such as this with a substantial following turns out to represent false values and thousands of investors are burned in the aftermath of forced disclosures, the damage to the investment process is considerable." And, "I believe the scope of a number of these cases, which really involve vast amounts of people's savings, are contributing to a crisis of confidence in the securities markets."

Vesco-International Controls Corp involved the looting of one of the largest mutual fund complexes, Investor Overseas Services, to the tune of $224 million, involving more than 40 defendants.

National Student Marketing involved false contracts to make earning's projections, and involved not only the president of the company, but the active participation of two major law firms and the independent accounting firm. Professional responsibility was a major factor in this case.

Conclusion.

Much has changed in thirty years and much has remained the same.

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