Summer 1993

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Securities Regulation: Challenges in the Decades Ahead†

J. WILLIAM HICKS* 

INTRODUCTION

The future of U.S. securities regulation is tied inextricably to this country’s commitment to global economic competition. Traditional areas of concern, such as the prevention and suppression of fraud and the regulation of securities markets, undoubtedly will take on new dimensions of complexity as the world moves toward more integrated financial markets. This Article will survey some of the important issues that loom as future challenges to government regulators, investors, participants in the securities industry, and courts. In Part I, three specific areas of concern are examined: the regulatory framework for financial services, the standards of regulation, and enforcement. How these issues are resolved will depend on the normative goals that underlie U.S. securities laws. Two of these goals—efficiency and protection of investors and securities markets—are likely to be at the core of future solutions. However, these goals are inherently bipolar. For example, an efficient system of regulation relies heavily on competition and free-market forces, while the protection of investors and securities markets hinges on legislative, administrative, judicial, and private restraints on free enterprise. Obviously, harmonizing these two goals is difficult, even where the issues are solely domestic. As international financial markets achieve greater integration and particular legal issues take on both domestic and international dimensions, this endeavor will become even more challenging.

Part II of this Article explores the theoretical side of securities regulation. Part III uses one substantive legal issue—the scope of private rights of action—to examine efficiency and protection of investors, two fundamental goals of securities law, which have been, and are likely to remain, operative in the resolution of particular legal issues, but which, because of the natural tension between them, require careful balancing.

I.

U.S. securities regulation is a collaborative effort. Congress, which enacted the Securities Act of 1933 (1933 Act), the Securities Exchange Act of 1934

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(1934 Act), and the other statutes, which are often collectively referred to as the "federal securities laws," responds to important developments in the securities markets with legislation. The authority to administer and interpret these federal statutes rests with the Securities and Exchange Commission (SEC or Commission), which directly regulates certain issuers of securities and key persons associated with them—broker-dealers and investment advisers—and certain organizations that perform critical roles in the trading and settlement of securities.

Some of the industry organizations that are subject to SEC oversight are partners with the Commission in the regulation of the securities industry. Included within this category are the so-called self-regulatory organizations (SROs), such as the eight active registered securities exchanges (for example, the New York Stock Exchange (NYSE) and the American Stock Exchange (AMEX)) and the National Association of Securities Dealers (NASD), each of which adopts rules and imposes sanctions on its members. In addition, important limitations on the offering and trading of securities become part of the applicable law because of contributions by the Department of Justice, which has exclusive authority to bring criminal prosecutions for securities law violations; by administrative law judges and federal court judges, who construe legislative and administrative pronouncements; and by members of the legal and accounting professions, who as scholars, practitioners, and advisers to government participate in the evolution of law.

State securities statutes in each of the fifty states provide a separate layer of regulation. This body of law, as interpreted by state securities administrators and state courts, is intended to supplement federal regulation. Since the early 1980s, the North American Securities Administrators Association (NASAA) has cooperated with the SEC in developing uniform regulations for both state and federal law.

All of these participants in the formulation, interpretation, and implementation of securities laws can look forward to challenging issues that will arise from the increased globalization of the securities markets and from dramatic

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4. Under 15 U.S.C. § 77s(c)(1), the SEC is authorized to develop greater federal and state cooperation in securities matters. Furthermore, under 15 U.S.C. § 77s(c)(2), the SEC is directed to cooperate in four specific areas: (1) maximum effectiveness of regulation, (2) maximum uniformity in federal and state regulatory standards, (3) minimum interference with the business of capital formation, and (4) a substantial reduction in costs and paperwork to diminish the burdens of raising investment capital and to diminish the costs of the administration of the government programs involved.
changes in the securities industry. Included among these challenges are issues concerning the regulatory framework for financial services, standards of regulation, and enforcement.

A. The Regulatory Framework

The present regulatory structure for securities firms, banks, and insurance companies was created for the most part in the 1930s. Regulation proceeded from the premise that the business activities of each component of the financial services industry should be carefully circumscribed and that separate federal or state agencies should be empowered to oversee and restrain each part of the industry. The regulatory controls that Congress and the states created were designed to remedy the abuses and excesses that occurred in the years leading up to the 1929 crash of the stock markets and to help resurrect the country from the ensuing economic depression. They were also intended to restore investor confidence in the basic tenets of the free enterprise system and in the nation's financial capital markets.

Within this grand design, the SEC has regulatory responsibility for broker-dealer firms, investment companies, and investment advisers, but it has virtually no authority over the activities of banks and insurance companies. The Federal Reserve Board regulates bank holding companies. The Comptroller of the Currency is responsible for controlling national banks, while the Federal Reserve Board and state authorities regulate state-chartered banks that are members of the Federal Reserve System. The Federal Deposit Insurance Corporation shares supervisory duties with state agencies in regulating nonmember banks that are federally insured. Savings and loan institutions were regulated by the Federal Home Loan Bank Board and the Federal Savings and Loan Insurance Corporation until 1989, when Congress abolished those agencies and replaced them with the Office of Thrift Supervision.5 State-chartered credit unions are regulated by state officials and federally chartered credit unions are the responsibility of the National Credit Union Administration. Two federal statutes, the Banking (Glass-Steagall) Act of 19336 and the Bank Holding Company Act,7 prohibit the combination of commercial banking with investment banking and commercial activities with banking. Insurance companies are regulated exclusively by the states. Under

the Employee Retirement Income Security Act of 1974 (ERISA), the Department of Labor and the Internal Revenue Service share jurisdiction over pension funds.

Much has changed since the 1930s regarding the capital markets in the financial services industry and in the regulatory environment. Investors can choose from a wide assortment of investment vehicles that are traded in many different markets. The money market offers a variety of short-term market instruments, including negotiable certificates of deposit, bankers' acceptances, treasury bills, and commercial paper. The U.S. government securities market consists of securities issued by the U.S. Treasury and all securities issued by government-sponsored enterprises, such as the Federal National Mortgage Association. The municipal securities market provides an outlet for debt instruments issued by a state or any of its political subdivisions or agencies. Corporate debt is sold and traded in the bond market. Markets also exist for so-called derivative instruments such as futures, options, forward contracts, and currency and interest-rate swaps. Some of these financial markets are limited to professionals, but increasingly, more of these markets are becoming available, directly or indirectly, to ordinary investors.

All investors have access to the traditional U.S. equity markets but the nature of those markets has changed dramatically. Even as late as 1975, American households dominated share holdings with seventy percent of the total equities outstanding. As of 1990, institutional investors, such as pension funds, mutual funds, insurance companies, and bank trust departments, held fifty-three percent of all equities. Along with the institutionalization of the markets has come an increased volume of trading activities by broker-dealers, hedge funds, and other market professionals; a more significant role for equity derivative products; the development of new trading strategies, especially program trading in a variety of forms; and a growth in foreign investment in U.S. equities.

11. Id.
12. Between 1980 and 1990, the value of foreign trading in U.S. stocks grew from $75 billion annually to approximately $417 billion, a 456% increase. Dep't of Commerce, Justice, and State, the Judiciary, and Related Agencies Appropriations for 1993: Hearings Before the Subcomm. of the Comm. on Appropriations, Part 6, 102d Cong., 2d Sess. 590 (1992) [hereinafter Appropriations for 1993]. During that same period, foreign purchases of U.S. debt securities increased from $122.9 billion to an estimated $3.9 trillion, an increase of 3,073%. Reauthorizations for the Securities and Exchange
The financial services industry has also undergone a transformation. During the past twenty years, commercial and financial institutions have successfully exploited soft spots in statutory restraints to broaden their product lines. This expansion of financial services was aided by a political atmosphere that championed deregulation, an economy that struggled through extended periods of instability, and an era marked by revolutionary developments in computer and communications technologies. By using holding companies with independent subsidiary corporations as the vehicle for transgressing traditional service boundaries:

insurance companies acquired mutual funds; mutual funds introduced money market accounts, with check writing privileges; retailers acquired securities brokers, thrifts and limited-service banks, also known as "nonbank banks"; securities brokers invented cash management margin accounts featuring check writing and credit card services; and credit card companies acquired banks and securities brokers.13

For their part, bank holding companies acquired discount brokers, insurance companies, and mutual funds. The immediate future promises further fragmentation of the banking industry and greater consolidation of financial services.

It is against these developments that Congress and other regulators of securities must assess the regulatory framework for the entire financial services industry. What seems obvious is the need for reform. The absence of a coherent federal policy on how best to regulate these crucial segments of the economy does more than create uncertainty about the scope of jurisdiction among the various state and federal regulators or raise questions about the risks of liability for firms seeking innovative responses to the challenges of competitors. It also fosters inefficiencies and inequities in capital markets both here and abroad. For instance, despite the economic interdependence of equity securities and equity index futures, equity securities and options relating to them are regulated by the SEC, but futures and futures on stock indices are regulated by the Commodity Futures Trading Commission. Predictably, some "hybrid" instruments are not easy to categorize as either equity securities or futures. Even where classification of an investment instrument is clear, the regulatory impact for similar financial arrangements varies significantly. Furthermore, purchasers of these securities encounter different regulation.

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Margin rules, which are administered by the Board of Governors of the Federal Reserve System, restrict borrowing for the purchase of equity securities but they do not apply to futures.\textsuperscript{14}

The absence of coordinated regulation also complicates U.S. regulation in globalized securities markets. For example, because of Glass-Steagall the U.S. securities exchanges are closed to commercial banks.\textsuperscript{15} But some U.S. banks avoid these limitations by trading abroad.\textsuperscript{16} Although their activities are beyond the reach of the SEC, these affiliates of U.S. banks engage in transactions with U.S. investors in securities issued by U.S. companies. In some countries, such as Germany, Austria, and Switzerland, banks are the primary, or the exclusive, securities traders. The chief purpose of stock exchanges in these countries is to provide a convenient place for banks to meet and conduct securities business.\textsuperscript{17} International linkages among markets and the growth of twenty-four-hour trading have made it possible for foreign banks in these countries to effect trading in U.S. securities by U.S. investors in competition with domestic securities firms.

The solution to these and other inequities in the law seems clear. In order for the United States to compete effectively in the global financial markets, while also ensuring that U.S. securities markets remain vibrant, fair, and economically efficient, the present regulatory framework must be reformed or replaced. The political costs of this approach are sure to be enormous. At a minimum, revamping the regulatory system will necessitate transfers of authority and jurisdiction among some of the many participating federal agencies.\textsuperscript{18} More radical reform might involve the elimination of one or more existing agencies.\textsuperscript{19} Reorganization is also likely to raise issues of federal

\textsuperscript{15}. Member banks of the Federal Reserve System are prohibited from dealing in securities. 12 U.S.C. §§ 24(7), 377.
\textsuperscript{17}. BRUNO SOLNIK, INTERNATIONAL INVESTMENTS 106-07 (2d ed. 1991).
\textsuperscript{18}. Consider, for example, the recent decision by the U.S. House of Representatives, which, by a vote of 279 to 124, rejected S. 1699, a bill aimed at reforming the government securities markets after revelations in 1991 about the activities of Salomon Brothers Inc. in the government securities auction market. See 138 CONG. REC. H8623 (daily ed. Sept. 16, 1992). House Banking Committee members opposed adoption of the bill because it would have removed the authority of banking regulators over government securities activities of insured depository institutions and instead would have given it to the SEC. 24 Sec. Reg. & L. Rep. (BNA) No. 37, 1479, 1479-80 (Sept. 18, 1992).
\textsuperscript{19}. In a speech on the fifth anniversary of the October 19, 1987, market break, Chicago Mercantile Exchange Chairman Jack Sandner recommended the creation of a single "super-agency" that would regulate securities, futures, options, and derivative products and that would become an integral part of the banking regulatory system. Chairman Sandner predicted that the proposed agency would be in place
preemption of traditional areas of state regulation, such as corporations, securities, insurance, and banking. Ultimately, however, Congress must determine what role the SEC and SROs will play in the national and international financial marketplaces.

B. Standards

The U.S. markets have served as a model for foreign markets by developing new investment products and by promoting competition among market professionals. They have also influenced the trend toward internationalization. The liquidity and efficiency of the U.S. securities markets can be traced in large part to the high quality of supervision and regulation that the SEC and SROs provide over market professionals and other participants in the issuance and trading of securities. But the rigorous standards that these regulators have developed, typically the toughest in the world, are being challenged by increasing competition among the international securities markets. As the standard bearer, the U.S. must be flexible in accommodating business practices around the world and in harmonizing U.S. regulations with those of other countries. The issue, of course, is how far Congress, the SEC, and the SROs can go in modifying rules and regulations without jeopardizing fair dealing and investor protection. Pressure to dilute existing standards, or to prevent the enactment or adoption of stronger norms, will continue to come from a variety of sources, including domestic participants in the securities industry, such as stock exchanges as they seek new members and new listings of securities;²⁰ foreign firms seeking entry to U.S. markets; members of multilateral institutions, such as the International Organization of Securities Commissions (IOSCO); and U.S. and foreign governmental officials. Even the SEC can be expected to experience internal debate on whether it can achieve its goal of removing barriers to access for U.S. securities and financial firms in foreign markets without diluting some or all of its standards. An examination of some of the more important standards at issue reveals the complexity and importance of this challenge.

within five to ten years. He argued that a new single agency was needed to improve the competitiveness of domestic financial markets and to trim regulatory costs stemming from jurisdictional disputes among the SEC, the Commodity Futures Trading Commission, and bank regulators on one level, and the congressional committees overseeing these agencies on another. 24 Sec. Reg. & L. Rep. (BNA) No. 42, 1629, 1633 (Oct. 23, 1992).

²⁰ For example, in an effort to offer direct listing of German stock on the NYSE, stock exchange officials sought an SEC compromise on the Commission’s accounting standards, which most German companies do not satisfy. The SEC refused to compromise. Jonathan Fuerbringer, SEC Says No on German Stocks, N.Y. TIMES, Apr. 26, 1992, § 3, at 15.
1. Full Disclosure

One of the essential missions of the SEC is to ensure that investors are provided with material information and are protected from fraud and misrepresentation in the public offering, trading, voting, and tendering of securities. The Commission's authority for mandating full disclosure of material facts in these instances is derived from the 1933 Act, which requires issuers to make disclosures concerning their business, financial affairs, and intended use of proceeds when they distribute their securities publicly, and from the 1934 Act, which requires issuers to file periodic reports with the SEC and to make disclosures in proxy solicitations, tender offers, and ownership reports. The staff of the SEC accomplishes this mission by reviewing filings, responding to inquiries through interpretive releases and no-action letters, and providing the public with access to the documents and reports that are filed with the Commission.

Disclosure to U.S. investors in connection with securities offerings and trading in foreign countries is markedly dissimilar. It depends on market conditions at the time of a transaction or, in those jurisdictions that have addressed the issue, on regulations that fall short of the disclosure guidelines in the United States. The Commission's modest success in overcoming the differences in disclosure requirements has been achieved by entering into bilateral and multilateral agreements with foreign countries where the disclosure systems are comparable.

2. Accounting Principles

Differences in accounting and auditing standards represent a significant hurdle to fully integrated international securities markets. In part, these differences can be explained by the manner in which accounting principles are established. In the United States, the SEC recognizes a private sector body, the Financial Accounting Standards Board (FASB), as the group of professionals with authority to establish standards of financial accounting and reporting. In developing accounting standards, the FASB employs a multi-step process that resembles the rule-making procedures used by the SEC. With very few

exceptions, the Commission has judged the determinations by the FASB as being responsive to the needs of investors.\textsuperscript{25}

In other countries, such as Japan, where governmental bodies promulgate accounting principles, tax regulations tend to influence the presentation of financial information. The objectives of fiscal authorities do not usually coincide with the needs of investors. Consequently, the obligation of professionals in these countries to conform their accounting principles to tax regulations frustrates the fair presentation of financial condition and operating results.\textsuperscript{26} Although the SEC has been under pressure to relax its financial disclosure standards, it continues to insist that foreign issuers comply with U.S. generally accepted accounting principles and auditing standards.

3. Net Capital Requirements

Capital adequacy standards ensure that market intermediaries will have sufficient resources to settle the securities transactions that they effect for themselves and their customers and to safeguard the cash and the securities that they hold for customers. Capital adequacy rules for securities firms contribute to investor confidence in the securities markets. The SEC's standards are set forth in rule 15c3-1 under the 1934 Act, which specifies minimum levels of net capital that a registered broker-dealer must maintain.\textsuperscript{27} U.S. stock exchanges and the NASD also have rules that require broker-dealers to maintain sufficient liquid assets to satisfy promptly the claims of customers and broker-dealers. But the increased internationalization of securities markets has created difficulties for the SEC and the SROs in their efforts to ensure the financial integrity of multinational firms.

Neither the SEC nor the SROs has the authority to examine and regulate the activities of unregistered overseas affiliates of U.S. registered broker-dealers. Efforts by the SEC and regulators from other countries to develop minimum net capital standards for all intermediaries have been complicated by at least two problems. First, even if standards of broker-dealer solvency are established for all securities firms, it is unlikely that they would apply to banks, which in certain countries play the exclusive or major role in securities transactions. Furthermore, because financial competence standards for banks


\textsuperscript{26} INTERNATIONAL MARKETS REPORT, supra note 16, ch. IV, at 1-8.

\textsuperscript{27} 17 C.F.R. § 240.15c3-1 (1992).
involve policy considerations that differ from those that inhere in the capital adequacy standards of securities firms, reconciliation of the standards will not be easy. So long as separate capital adequacy standards exist for banks and securities firms, one side is likely to enjoy a competitive advantage in the international markets. Second, net capital requirements that are too demanding can end up hurting investors. Exacting capital adequacy standards are clearly desirable because of the added protection they offer against failures of securities firms and the resulting harm to customers and, in the collapse of a major firm, investors and markets throughout the world. But capital adequacy standards that are too rigorous can also serve as a barrier to entry into markets. Where this barrier exists, investors are denied the benefits of competition from excluded securities firms that are otherwise financially responsible.\(^{28}\)

4. Transparency, Clearance, and Settlement

The U.S. markets in general have achieved a high level of transparency, that is, the degree to which real-time trade and quote information is disseminated to market participants.\(^{29}\) Purchasers and sellers have access to current market information and are therefore in a better position to assess the market value of securities, to evaluate the fairness of fees or brokerage charges that they pay to intermediaries, and to assist regulators in controlling trading abuses such as insider trading.

Most foreign markets lag behind the United States in the development of effective trade and quote reporting mechanisms.\(^{30}\) And yet it is in these markets where foreign broker-dealers are competing for order flow in many U.S. securities and where domestic broker-dealers are finding lower costs, both in terms of fees and regulation, in connection with trades that they execute. U.S. investors who participate in these foreign markets run the risk of relying on trade and quotation information that is stale and possibly materially misleading. A pressing challenge, then, is to develop the means for integrating widely differing foreign systems for the publication of transaction reports.

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An equally serious problem is the lack of international clearance and settlement links to facilitate cross-border settlements. This causes delays in transfers of securities and cash, subjecting the parties to higher costs and greater risks of nonperformance, loss, and theft. Furthermore, the widely varying clearance and settlement systems that exist among the world’s securities markets will hamper efforts to achieve greater uniformity.

5. Insider Trading

Under U.S. securities law, corporate insiders, particularly officers, directors, and controlling shareholders, have an affirmative duty of disclosure when dealing in securities. Where an insider, or under certain circumstances a tippee of that person, fails to disclose material nonpublic information before trading on it, he or she may be liable in damages to all the persons who trade at the same time in the market. Insider trading liability can also attach to persons who have no connection with the issuer but who purchase or sell securities on the basis of material nonpublic “market information” in breach of a fiduciary duty or a relationship of trust or confidence. Internationalized markets offer new opportunities to persons who, because of their privileged position within the issuer, markets, or even government, or because of their friendship or association with persons in privileged positions, are able to realize secret profits in cross-border securities transactions.

Although the United States considers insider trading a threat to fair and efficient securities markets, this view is not shared by all nations. The trend within the international community is toward some form of insider trading

35. Market information relates to the supply and demand for a particular security.
prohibition, but definitions of such abuse vary considerably.\textsuperscript{37} Before the SEC or other regulatory authorities can hope to develop a uniform standard for international regulation, Congress or the SEC must first decide on a clear definition of "insider trading" under U.S. securities laws. At present, neither the federal statutes nor the Commission's rules define this crucial term and U.S. Supreme Court decisions that have addressed the issue do not resolve ambiguities about either the scope or the underlying theory of this variety of fraud. The uncertain parameters of insider trading under U.S. law are more than an inconvenience. In addition to creating the risk of civil liability, a violation of statutory provisions or SEC rules that prohibit insider trading can result in a criminal conviction. Furthermore, insider trading liability is not confined to persons who engage in domestic transactions. Judicial decisions in the United States have extended the Commission's enforcement authority to foreign securities transactions that have a significant connection with the United States.\textsuperscript{38}

C. Enforcement

In recent years, U.S. and foreign securities markets have grown dramatically in size and sophistication. The need for strong deterrence against fraud and other violations of U.S. securities laws is and will continue to be intense in the highly charged atmosphere of round-the-clock trading that is sparked by expanding global markets. Although responsibility for the prevention and suppression of illegal securities activities is shared by SROs, the Department of Justice, and private litigants and their attorneys, the SEC will most likely continue to shoulder the heaviest enforcement load. An issue of critical importance is whether the Commission will be capable of discharging its statutory obligation of enforcement in view of the many complex issues that will confront it.

One dimension of this issue is the magnitude of the enforcement problem. The evidence suggests that, at least in the near future, the SEC will be faced with significant annual increases in the volume of domestic and transnational securities transactions; in the number of registrations by companies, broker-dealers, investment advisers, and money-management funds investing


\textsuperscript{38} Subject matter jurisdiction can be found under either the so-called "effect" test, e.g., SEC v. Unifund SAL, 910 F.2d 1028, 1033 (2d Cir. 1990), or the "conduct" test, e.g., Leasco Data Processing Equip. Corp. v. Maxwell, 468 F.2d 1326, 1340 (2d Cir. 1972). The SEC has estimated that approximately 30% of the major trading cases in recent years had some international dimension. Appropriations for 1993, supra note 12, at 683.
substantial portions of their assets in foreign securities; in the complexity of financial transactions and financial products utilized by issuers and professionals in the U.S. and foreign capital markets; and in the incidents of fraud and other trading abuses.\textsuperscript{39}

Another aspect of the Commission's challenge is whether it will have adequate resources to do its job properly. The SEC's enforcement program evolves from intelligence analyses to investigations and ultimately to administrative or civil proceedings. The first two stages of enforcement are especially dependent upon sophisticated technology, skilled and experienced personnel, and cooperative arrangements with other regulators. Consequently, the success of future securities regulation is linked to substantial budgetary support by Congress. Future factors, such as the strength of the national economy and the public's attitude toward governmental regulation;\textsuperscript{40} are obviously relevant to the levels of financial support that the SEC can expect.

Inadequate authorization for appropriation will seriously handicap the Commission's ongoing efforts to develop and expand computer systems to receive, process, and disseminate electronic filings and to receive, store, and analyze data. Some of the information that is generated by SEC computer systems yields evidence against broker-dealers and their affiliates that appear to be shielding financial problems and insiders of registered companies and institutional investors that are suspected of trading abuses.\textsuperscript{41} SROs also depend upon some of the trading information generated by the SEC for their own market surveillance and, therefore, are impacted by improvement or deterioration in SEC technology.

Equally important to vigorous SEC enforcement are the recruitment and retention of a sufficient quantity of talented and dedicated attorneys, economists, accountants, compliance examiners, computer specialists, and secretaries. Because of market forces and inferior compensation packages at the SEC, the Commission's turnover rate for staff attorneys, who handle all of the agency's litigation, has historically exceeded the turnover rates at other federal agencies.\textsuperscript{41} Maintaining the staff is only part of the problem. The

\textsuperscript{39} See, e.g., Appropriations for 1993, supra note 12, at 590-91.
\textsuperscript{40} Id. at 653-59 (testimony of Richard C. Breeden, SEC Chairman). The SEC's Electronic Data Gathering, Analysis, and Retrieval (EDGAR) system, which is designed to automate the receipt, processing, and dissemination of documents filed with the Commission, will cost an estimated $10.3 million for 1993 even though it is not yet fully operational. Id. at 571-75. The development of the large trader reporting system and the risk assessment system for broker-dealers will require significant expenditures for both hardware and software. Each system is expected to cost in excess of $1 million to operate each year. Id. at 653-54.
\textsuperscript{41} See SEC Reauthorizations for 1992-94, supra note 12, at 53-54. Based on the historical turnover rate for the SEC, the Commission anticipates that between fiscal years 1991 and 1995 there will be an 85% turnover in all current staff positions and a 90% turnover in attorney positions. Id. at 53 (testimony of Richard C. Breeden, SEC Chairman).
increasing internationalization of the world’s securities markets means that the SEC will require an even larger staff of specialists who are trained in the complexities of international finance and fraud.

Finally, even if the Commission possesses the technology and personnel to enforce the federal securities laws, other challenges remain. The international dimension of the SEC’s enforcement program creates issues concerning the gathering of evidence abroad, service of process through international conventions and other means, freezing assets overseas, and enforcing judgments against foreign parties. The Commission has reached temporary solutions to these problems with some foreign securities regulators. A comprehensive solution, however, must await future negotiation and discussion among members of the IOSCO Technical Committee, which is developing enforcement cooperation on a multilateral basis.

II.

Securities regulation, like other areas of law, evolves in anticipation of and in response to change. The recent, high-speed transformation of national and international financial markets is strong evidence that dramatic change in those markets will persist and that securities law will continue to evolve. Part I identified some of the more recent changes in the world’s markets as well as some of the legal issues that those developments have created for persons who participate in shaping securities regulation. It is a safe bet that the securities laws of the future will provide solutions to most of the pressing legal problems. But the fairness of regulatory solutions, individually and collectively, will persist as a separate issue. As the following discussion indicates, an important challenge for those who influence securities law is to develop better methods for assessing the impact of change, in the marketplace and in all forms of regulation, on particular aspects of securities regulation and on securities law as a whole. The scope and importance of this challenge can be appreciated by examining the theoretical and practical implications of two regulatory policies that are the foundation of U.S. securities laws: market efficiency and investor protection.

U.S. securities law is the product of an endless number of compromises between the private and public interests in the securities markets. The private interest flows naturally from the basic tenets of our capitalistic society. It

42. As of 1992 the SEC had signed a memorandum of understanding (MOU) with regulators in 15 countries, including Brazil, Canada, France, Italy, Japan, Switzerland, and the United Kingdom. Richard M. Phillips & Gilbert C. Miller, The Internationalization of Securities Fraud Enforcement in the 1990s, 25 REV. OF SEC. & COMMODITIES REG. 119, 127-28 (1992).
reflects the fundamental belief that individuals or groups of individuals are entitled to maximum freedom in the ownership and use of their private property in an economy where market forces and competition are the predominant limitations. The private interest entitles issuers, intermediaries, and investors to a regulatory climate where all unnecessary impediments to efficient markets are eliminated.

The public interest in the securities markets is equally clear. Securities are an important form of private property, but they also represent an integral element of the resources of a large segment of this country's population. The public has a legitimate interest in the long-term financial security of its important resources. Further, the safety and soundness of the trading markets have a direct bearing on the flow of new capital into private enterprise and thus on the country's rate of economic growth. Finally, the securities markets can also affect the nation's general economy and well-being, as they did in 1929 and 1987, in ways that Congress described in section 2(4) of the 1934 Act:

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\text{National emergencies, which produce widespread unemployment and the dislocation of trade, transportation, and industry, and which burden interstate commerce and adversely affect the general welfare, are precipitated, intensified, and prolonged by manipulation and sudden and unreasonable fluctuations of security prices and by excessive speculation on such exchanges and markets . . . .}
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For these reasons, Congress determined that the public interest in the securities markets was sufficiently strong to justify imposing federal restraints on the private interest in those markets. As a result, securities regulation has existed at the national level since 1933. The theoretical underpinning of these laws seems to require that they undergo periodic examination and assessment to determine whether the private and public interests are receiving legitimate recognition. In theory, securities law is optimal where at any given moment a proper balance is struck between the private interest, which stresses freedom and efficiency, and the public interest, which allows for limitations and proscriptions.

There is no doubt that securities regulators are sensitive to the conflicts between the private and public interests in the securities markets. Congressional committees hold hearings on proposed legislation and elicit testimony and

written expressions of opinion on controversial topics. Courts consider the
policy implications of the legal positions advanced in litigation. The SEC as
a matter of course invites the public to submit views and data regarding the
costs and benefits associated with proposed rules or amendments to existing
rules. Each of these efforts at cost-benefit analysis is useful, but none
provides the ongoing and comprehensive monitoring that the theoretical model
demands.

One of the problems with the present system is that securities law addresses
so many technical, interdependent facets of the financial markets and changes
so rapidly that it has become increasingly difficult to articulate the current
state of the law. Without that information, it is impossible to assess the
impact of changes in the marketplace or in particular rules or regulations. The
more serious problem, however, is that the forces in the marketplace that
affect regulation are so numerous, and at times so subtle, that accurate
identification and assessment of relevant changes seem unattainable.

Many changes in the regulatory environment emanate from ordinary events
of the day. Shifts in attitudes toward government, the economy, world politics,
and business in general can and do influence the actions of investors. Other
changes are produced by business firms and promoters seeking new capital
and by market professionals looking for new ways to earn profits. Any
alteration in the mix of securities being offered for sale to the public,
including the issuance of additional securities of the same class as those
outstanding, affects investor choice in obvious ways. However, the impact that
new investment opportunities have on particular groups of investors or
particular markets is less certain. A new issue that succeeds in one market
might be a failure in another market. For instance, investors who are
interested in trading penny stock in the over-the-counter market might be
indifferent to the availability of innovative limited partnership interests in a
local private placement market. Similarly, the introduction of investment
products in one market and the resulting changes that the new products create
in that market might have little, if any, effect on other securities markets. The
issuance of an unusually attractive investment product, for example, could
produce a surge of activity among speculators in the over-the-counter market
or among sophisticated investors in the private placement market accompanied
by fraudulent sales efforts or manipulation of market prices. If these deceptive
practices are widespread, they are certain to threaten the integrity of the over-
the-counter and private placement markets. But these abuses would probably
leave undisturbed the ordinary trading activity on the stock exchanges, in the
bond market, and in the proprietary trading markets of institutions and market
professionals.
Changes in the marketplace also occur because of limitations imposed by private persons, such as investors who engage in fraud or pursue meritless litigation, and by nongovernmental entities, such as stock exchanges, the NASD, bar associations, and auditing and accounting boards. At the same time, the marketplace is influenced by decisions rendered by governmental bodies, such as the SEC, the Federal Reserve and other banking regulators, the Internal Revenue Service, and the federal and state courts. Private and public counterparts in foreign countries possess the same ability to influence behavior and attitudes in their financial and securities markets. Alteration of the status quo by any of these forces not only affects the way issuers, intermediaries, and investors perceive investment opportunities and securities markets, but also changes the entire corpus of the securities law that regulates these persons.

The cumulative effect of changes in the marketplace and changes in securities law as a whole is a regulatory environment in flux—one that is continuously moving closer to or farther away from a balance between noninterference and restraint. It is for this reason that securities regulators should regularly monitor and, where appropriate, increase or decrease the level of regulation. The practical implications of this responsibility can be appreciated by examining one area of securities law that has undergone significant change: private rights of action arising from a violation of the 1933 and 1934 Acts.

III.

There is universal agreement that private actions under the federal securities laws are a necessary supplement to actions brought by the SEC and the Department of Justice. Limited resources prevent the government from detecting and prosecuting all violations of the federal securities laws. Private actions also provide additional deterrence against securities law violations and permit defrauded investors to seek compensation. The overwhelming majority of private claims under the securities laws allege fraud or violations of the registration requirements of the 1933 Act. Whether functioning as private attorneys general or as injured investors, private litigants can choose among several remedies. However, remedies under two provisions stand out. Section 10(b) of the 1934 Act and rule 10b-5

47. 15 U.S.C. § 78j(b).
48.
thereunder represent the core of the federal securities laws that prohibit deliberate fraud by purchasers or sellers against investors. The U.S. Supreme Court has recognized that a private right of action is implied under section 10(b). Section 12 of the 1933 Act is the only basis for a private action for rescission or damages against a seller who offered or sold securities in violation of the registration requirements. It also provides relief against fraud, but only in connection with the sale of securities. A brief comparison of these two remedies in their present form with their status in the early 1970s reveals how extensively one aspect of investor protection has changed, namely, private enforcement of the securities laws.

A. Rule 10b-5

To succeed under rule 10b-5, a claimant must prove that (1) in connection with the purchase or sale of a security, (2) involving the requisite jurisdictional means, (3) the defendant made a misrepresentation or omission of a material fact, (4) with the proper state of mind, (5) upon which the plaintiff reasonably relied, and (6) which proximately caused the plaintiff's damage. These six elements have not changed during the past twenty years, but judicial interpretations have altered their meaning. Although the requirement of reliance is now easier for plaintiffs to satisfy, a series of decisions by the U.S. Supreme Court, involving three of the remaining five elements as well as the limitations period defense, have significantly weakened rule 10b-5.

In Blue Chip Stamps v. Manor Drug Stores, the Supreme Court construed the so-called Birnbaum rule, which limits rule 10b-5 actions to purchasers or sellers. Prior to Blue Chip Stamps, many federal courts interpreted Birnbaum flexibly and established a number of exceptions and qualifications to the proposition that a plaintiff must be a purchaser or seller. These courts extended standing to sue to "aborted sellers," "frustrated sellers," and

53. Id. § 36.
57. See, e.g., Richardson v. MacArthur, 451 F.2d 35, 40 (10th Cir. 1971).
other potential investors on a case-by-case basis through particularized judicial inquiry into the facts surrounding a complaint. In *Blue Chip Stamps*, a majority of the Supreme Court announced its support for the "straightforward application of the Birnbaum rule," thereby narrowing the category of persons who are eligible to sue under rule 10b-5.\(^{59}\)

In *TSC Industries v. Northway, Inc.*\(^{61}\) and *Chiarella v. United States*,\(^{62}\) the Supreme Court tightened the rule even further through interpretations of two aspects of the requirement that the defendant make a misrepresentation or omission of material facts. In *TSC Industries*, the Court was asked to formulate a test of materiality for purposes of rule 14a-9,\(^{63}\) a special antifraud rule for use in connection with the solicitation of proxies. Prior to this, some federal courts had concluded that a determination of materiality depended on whether a reasonable shareholder *might* have been influenced by a misstatement in a proxy statement or other solicitation material.\(^{64}\) The Supreme Court judged this standard to be inconsistent with the disclosure policy embodied in the proxy regulations.\(^{65}\) In a decision that was applied immediately by all courts to rule 10b-5 cases, the Court rejected the "might" formulation, which was too suggestive of mere possibility, in favor of a tougher "would" standard that contemplates a showing of a substantial likelihood that a reasonable person would attach importance to an omitted or misstated fact in determining his or her choice of action in the transaction.\(^{66}\)

In *Chiarella*,\(^{67}\) an insider trading case, the Court addressed the prerequisites of a section 10(b) case that was grounded on nondisclosure of a material

60. Id. at 747.
64. See, e.g., Northway, Inc. v. TSC Industries, 512 F.2d 324, 332 (7th Cir. 1975), rev'd, 426 U.S. 438 (1976); Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 495 F.2d 228, 240 (2d Cir. 1974).
65. *TSC Industries*, 426 U.S. at 448-49. The Court stated:

Some information is of such dubious significance that insistence on its disclosure may accomplish more harm than good. The potential liability for a Rule 14a-9 violation can be great indeed, and if the standard of materiality is unnecessarily low, not only may the corporation and its management be subjected to liability for insignificant omissions or misstatements, but also management's fear of exposing itself to substantial liability may cause it simply to bury the shareholders in an avalanche of trivial information—a result that is hardly conducive to informed decisionmaking.

Id.
66. Id. at 449. The Court adopted the *TSC Industries* standard for purposes of section 10(b) and rule 10b-5 in *Basic, Inc. v. Levinson*, 485 U.S. 224, 240 (1988).
fact. The Court was presented with the view, articulated most frequently by the Second Circuit, that the federal securities laws have "created a system providing equal access to the information necessary for reasoned and intelligent investment decisions."\(^{68}\) Under this theory, the use by anyone of material information not generally available to the public is fraudulent because the information gives certain buyers or sellers an unfair advantage over less informed buyers and sellers. In a divided opinion, the Court disagreed and held that "[w]hen an allegation of fraud is based on nondisclosure, there can be no fraud absent a duty to speak."\(^{69}\) According to a majority of the Court, a duty to disclose material nonpublic information is not created by an informational advantage, but arises "from a relationship of trust and confidence between parties to a transaction."\(^{70}\)

On still another element of rule 10b-5, the standard of culpability, the Supreme Court in *Ernst & Ernst v. Hochfelder*\(^{71}\) opted for the narrower construction. A majority of the Justices refused to follow lower court decisions announcing that some form of negligence would suffice for civil liability under rule 10b-5, and instead required an allegation of scienter—intent to deceive, manipulate, or defraud.\(^{72}\) Finally, in *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*,\(^{73}\) the Court, by a vote of five to four, adopted a uniform limitations period for private actions under section 10(b) that requires defrauded investors to bring actions within one year of discovery of the facts constituting the fraud, but in no event later than three years after the fraud occurred.\(^{74}\) Before *Lampf*, federal courts tended to borrow the most analogous state statute of limitations, many of which were longer than the one-year/three-year structure adopted by the Court, and to apply the general equitable tolling doctrine, which extended the period of repose even further.\(^{75}\) *Lampf* states explicitly that tolling principles do not apply to the one-year/three-year rule.\(^{76}\)

70. Id. at 230.
72. Id. at 193 & n.12.
74. Id. at 2782.
75. See generally 5 JACOBS, supra note 52, § 235; JENNINGS ET AL., supra note 13, at 1310-13.
76. Lampf, 111 S. Ct. at 2782.
B. Section 12(1)

Under section 5 of the 1933 Act, any person who offers or sells a security must either file a registration statement with the SEC or qualify for an exemption. Section 12(1), essentially a strict liability provision, braces this registration requirement by giving purchasers of unregistered, nonexempt securities an opportunity to rescind a transaction. A purchaser states a prima facie case under section 12(1) by proving that (1) a registration statement covering the securities was not in effect, (2) the defendant offered or sold the securities to the plaintiff, (3) the requisite jurisdictional means were employed, and (4) the suit was commenced in compliance with the statute of limitations. The burden then shifts to the defendant to prove that the offer or sale was exempted from section 5.

Two developments in recent years, one judicial and the other administrative, have weakened this remedy. Until the Supreme Court's decision in Pinter v. Dahl, most federal courts permitted a section 12(1) plaintiff to seek relief from the actual owner who passed title of the security to the purchaser or from a collateral participant in the transaction who was judged to be a substantial factor in causing the unlawful sale to occur. Employing one of three different tests for expanding the category of seller, courts imposed section 12(1) liability on a variety of participants in unlawful sales, including: corporate directors and officers, general partners, attorneys, accountants, and lending institutions.

In Pinter, the Court found all of these judicial tests for section 12(1) seller status incompatible with congressional intent. Although the Court rejected a strict privity approach to the civil liability provision, it decided that section 12(1) liability extends only to the owner of securities and to the person "who successfully solicits the purchase, motivated at least in part by a desire to serve his own financial interests or those of the securities owner." Subsequent judicial interpretations of the Pinter test by lower courts indicate

81. 17 HICKS, supra note 79, § 5.04[2][b][ii]; see, e.g., Pharo v. Smith, 621 F.2d 656 (5th Cir. 1980).
82. See generally 17 & 17A HICKS, supra note 79, §§ 5.04[2], 6.03[4].
83. Pinter, 486 U.S. at 647.
that in most instances only the technical owner of a security will qualify as a section 12(1) seller.\textsuperscript{84}

The adoption of rule 508\textsuperscript{85} in March, 1989, also weakened section 12(1). Generally, a seller of unregistered securities could avoid civil liability under section 12(1) only by proving that it satisfied all of the terms and conditions of the exemption claimed. Failure to comply with one condition, which might rank as relatively insignificant in relation to other conditions, would still result in liability. Rule 508 represents a dramatic change in the law. In essence, it provides a substantial, good-faith compliance defense against private actions of rescission under section 12(1) for an issuer relying upon an exemption under Regulation D.\textsuperscript{86} Because many offerings of unregistered securities are made in reliance on Regulation D, the "safe harbor" rule makes section 12(1) rescission suits more difficult to win.

\textit{C. Assessment}

The diminished strength of private rights of action under rule 10b-5 or section 12(1) does not necessarily mean that securities regulators should take immediate corrective action. As explained earlier,\textsuperscript{87} judgments concerning the fairness of one particular aspect of securities law should not be made in isolation. What is needed is an assessment of the entire body of securities law, including the part under consideration and the conditions in the securities markets, in order to determine whether additional regulation or deregulation is desirable. Ideally, this assessment should occur continuously, but it is certainly needed where an unusual event occurs in the marketplace or where a change in regulatory policy is proposed or likely to happen.

Consider again the scope of private rights of action. Even where the issue of fairness is precipitated by a single event—such as proposed legislation, a new administrative rule, or an important judicial decision—the practical limitations of a comprehensive appraisal are staggering. The present state of the law under rule 10b-5 and section 12(1), even if accurately captured in the discussion above, is not static. Congress continues to consider bills that would establish a longer limitation period for private rights of action under rule 10b-5,\textsuperscript{88} which, if enacted, would benefit investors. But Congress is also faced

\textsuperscript{84} See generally 17A HICKS, supra note 79, at § 6.03[5].
\textsuperscript{86} See generally 17 HICKS, supra note 79, at § 5.09[2].
\textsuperscript{87} See supra text accompanying notes 42-45.
with bills that would introduce proportionate liability in rule 10b-5 suits, instead of the current joint and several liability, and shift legal fees and expenses of the winning party to the loser in some suits.\textsuperscript{89} Both of these legislative proposals, if enacted, would further diminish the rights of investors.\textsuperscript{90}

Judicial interpretations of these remedies persist, and the SEC shows no signs of abandoning its policy of deregulating limited offerings of unregistered securities with a corresponding reduction in the burden of proof for issuers faced with section 12(1) suits.\textsuperscript{91} Adding to the practical problems of an assessment is the fact that private rights of action represent only a part of investor protection, and therefore, must be evaluated in the context of other regulation, such as the SEC enforcement program, which may or may not compensate for weaker private remedies.\textsuperscript{92} Finally, all of these regulations


\textsuperscript{90} See, for example, Investors Legal Rights, supra note 46, at 118, where Professor Arthur R. Miller of Harvard University Law School stated that the proposed abrogation of joint and several liability in securities fraud cases and the adoption of the English rule on attorneys' fees "would eviscerate all plaintiffs' litigation, the meritorious along with the meritless." \textit{Id.} (emphasis in original).

He described joint and several liability as essential to deter wrongdoing:

This rule of ancient origin correctly recognizes that a conspiracy cannot be effective without the participation of each member. If any member blows the whistle, then the conspiracy falls apart. The perpetration of a complex financial fraud is impossible without the active assistance of professionals such as investment bankers, lawyers, and accountants who must be held accountable. Requiring every defendant to pay damages may be the single most important aspect of the current liability system that Congress needs to preserve in order to deter the future Milkins, Boeskys, and Keatings from perpetrating their frauds.

\textit{Id.} at 119.

Professor Miller explained his opinion that no one, no matter how strong his or her claim appeared, would assume the risk of pursuing a private claim against wealthy defendants under a rule that imposed all legal costs on the loser:

Litigation success is never certain. In the securities context, if there is even a remote possibility that a class plaintiff would have to pay the legal fees of the defendants, it would be a major deterrent to anyone seeking to remedy a justiciable wrong. Illustratively, I am informed that Drexel was prepared to spend $1 billion in its defense and that it was paying Milken's lawyers over $2 million per month at the height of the government's enforcement activities. Who would risk paying the staggering legal fees of these wrongdoers if there was a chance the defendants would defeat a civil suit—perhaps on a technical defense such as the statute of limitations—leaving the "loser" responsible for the fees?

\textit{Id.} at 118-19.


\textsuperscript{92} The SEC's enforcement powers were augmented in October, 1990, by two laws that are among the most significant changes in the securities laws in decades: the Market Reform Act of 1990, Pub. L. No. 101-432, 104 Stat. 963 (codified in scattered sections of 12 U.S.C. and 15 U.S.C.), and the
must be integrated with the remaining components of securities regulation, such as registration and reporting obligations under the 1934 Act, for an even broader assessment of investor protection.

Equally important to a judgment regarding the proper scope of rule 10b-5 and section 12(1) is an examination of the marketplace to determine the pressures that it is placing on the participants in the securities markets as well as the pressures that it is experiencing from all forms of regulation. A general overview of the marketplace in its present state has already been provided. More specific market information is required to respond to the issue prompting the assessment. For example, it would seem that the weakening of private rights of action under rule 10b-5 and section 12(1) has had an impact in the markets that is difficult to measure but nonetheless relevant. Less effective private actions reduce the level of deterrence against fraud and registration violations, thereby making investments more hazardous and less attractive to investors. At some point, less deterrence will result in less participation in U.S. securities markets and a higher cost of capital for business. Data on the strength or weakness of the private placement market are needed since section 12(1) is especially valuable to investors in primary issues of unregistered securities. Also relevant would be information about the incidence and complexity of securities fraud and the average period of time

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Securities Enforcement Remedies and Penny Stock Reform Act, Pub. L. No. 101-429, 104 Stat. 931 (1990) (codified in scattered sections of 15 U.S.C.). The Market Reform Act provided the SEC with powers to monitor and stabilize the national securities markets, including the authority to suspend trading during a market emergency, to restrict trading practices in equity securities during periods of extraordinary market volatility, to preempt state laws governing the transfer and pledge of securities during periods of extraordinary market volatility, to preempt state laws governing the transfer and pledge of securities where necessary for the safe and efficient operation of the national clearance and settlement system, and to coordinate initiatives with other federal regulatory agencies. The Remedies Act greatly expands the SEC's enforcement capabilities by authorizing monetary penalties in both civil and administrative proceedings. It also authorizes the Commission to institute administrative proceedings to obtain cease-and-desist orders against, and impose disgorgement on, any person for violations of the federal securities laws.

93. See supra text accompanying notes 10-12.

94. Many securities regulators believe that fraud in the financial and investment markets has reached dramatic proportions and that prosecutorial and regulatory resources remain severely limited. See, e.g., Investors Legal Rights, supra note 46, at 64, 68 (statement of Mark J. Griffin on behalf of NASAA). Investors have brought private actions under rule 10b-5 in the past few decades in the most flagrant cases of abusive conduct in the markets, including insider trading and market manipulation (e.g., Ivan Boesky, Michael Milken), mutual fund fraud (e.g., Robert Vesco, Bernard Cornfeld), bank and savings and loan fraud (e.g., American Continental Corporation/Lincoln Savings, Centrust Savings and Loan, Penn Square Bank), government securities fraud (e.g., Drysdale Securities, ESM), and financial statement fraud (e.g., ZZZZ Best, Penn Central Corporation, Baldwin-United, Equity Funding). Id. at 19 (testimony of Richard C. Breeden, Chairman of SEC).
that it remains concealed from government regulators and investors.\textsuperscript{95} Finally, an evaluation of the marketplace would not be complete without an opinion on the level and costs of all regulation in the financial markets. Evidence of deregulation in the financial services industry during the past twenty years, of the type described earlier,\textsuperscript{96} and other manifestations of laissez-faire in the SEC and the courts during this period of time would be useful for such an evaluation.

The daunting task of gathering information on the state of securities law and of the marketplace does not get easier at the final stage. Assuming that a securities regulator succeeded in reaching this stage of analysis, armed with relevant data and well-founded preliminary opinions with respect to a proposed change in a private right of action, it must still determine whether acting on the proposal would be beneficial to all of the participants in the capital markets. What is beneficial depends on the status of the regulatory environment in relationship to the optimal balance between free enterprise and restraint.

**CONCLUSION**

In the four decades following the enactment of the 1933 and 1934 Acts, U.S. securities regulators operated within a legal structure that restricted competition among participants in the financial services industry. The legal problems that they addressed were predominantly domestic in scope. During the past twenty years, both of these characteristics of federal securities regulation have changed. These years have been marked by extraordinary developments in the financial services industry and in all segments of the securities business. With these changes have come phenomenal growth in the complexity, volume, and availability of financial and investment instruments and a transformation of U.S. securities law from national to transnational

\textsuperscript{95} SEC Chairman Richard C. Breeden offered the following comments:

Securities fraud entails a much greater potential for concealment or deception than the typical consumer fraud. Unlike the purchaser of a used car, who can take it for a test drive, or give it to a mechanic of his own choice for inspection, a purchaser of a security is often not in a position to detect financial fraud. Moreover, product defects typically manifest themselves within a short time. The consequences of financial fraud and misrepresentations, in contrast, may not become apparent for years. For example, fraudulent tax-shelters are seldom discovered until years later when the IRS disallows the tax deduction, or the projected long-term profit does not materialize.

\textit{Id.} at 25. Mark J. Griffin, deputy secretary, Securities Division, State of Nevada, on behalf of NASAA, testified that in his experience most elaborate schemes are not discovered until seven years after they originate. \textit{Id.} at 180.

\textsuperscript{96} See \textit{supra} text accompanying note 13.
regulation. These trends show no sign of abating in the decades ahead. Consequently, it is imperative for U.S. securities regulators to develop and implement reforms to modernize the financial services regulatory system; to develop appropriate domestic and international standards concerning disclosure requirements, accounting and auditing practices, broker-dealer capital adequacy rules, transparency, clearance and settlement systems, and insider trading; and to structure an enforcement program that remains effective in the evolving world markets.

Equally important, regulators must evaluate securities law in the context of international regulation in order to ensure that restraints on issuers, market intermediaries, and investors do not unfairly impede competition and efficiency in the capital markets. Achieving this objective in connection with particular legal issues, such as the scope of private rights of action, will never come easily given the many practical problems of gathering relevant data and of balancing competing interests. But the theoretical model for achieving fair regulation encompasses any legal issue regardless of the practical difficulties or the size of the marketplace. The challenge is to develop the capabilities for applying it effectively in a regulatory environment that is increasingly global.