



SECURITIES AND EXCHANGE COMMISSION

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SEC CHAIRMAN CITES NEED TO REDUCE CAPITAL FORMATION DISINCENTIVES

Chairman John S.R. Shad today called for policies that would reverse trends that have led to disincentives to capital formation.

"Pushed by inflation into higher tax brackets without gains in real disposable income individual investors are being attracted to securities which offer tax free returns and to marginal, illiquid tax shelter and other tax deferment vehicles," Chairman Shad said, "Reversal of these trends is essential if the United States is to maintain its per capita income, standard of living and position within the keenly competitive world economy."

Pointing out that equity investments used to be considered an effective inflation hedge Chairman Shad noted, "the Dow Jones Industrial Average is presently at approximately the 1968 level, despite the 256% interim increase in the cost of living index." His testimony this morning provided an overview of the securities industry for the Subcommittee on Telecommunications, Consumer Protection and Finance of the House Committee on Energy and Commerce.

Turning to the effect inflation and taxation has had on business and industry, Chairman Shad pointed out that, "Few corporations earn sustained returns on investments that exceed the interest rates currently available on government bonds, not to mention the even higher rates paid on corporate

debt securities. Today's high rates of inflation and taxation coupled with relatively low depreciation allowances, have inhibited industry's ability to maintain the nation's plant and equipment, and in many instances have precluded plant modernization and expansion."

With regard to the spectacular growth enjoyed by money market funds, he said their success is in part because they offer small investors the opportunity to obtain the kind of high yields and liquidity which previously were enjoyed by those who could afford to purchase \$100,000 and larger, short term instruments. Public acceptance of the funds is also due, he said, to confidence in the regulatory system under which the funds operate.

Chairman Shad told the subcommittee that consolidations within the securities industry do not appear to have seriously threatened the ability of smaller firms to compete. He also said if present tax and inflationary trends persist, investment bankers and brokers could be expected to develop new instruments to accommodate individual and institutional investors, and the long term capital requirements of government and industry.

Concerning the recent mergers of several securities firms with large, diversified financial services companies, Mr. Shad said such arrangements could provide broker-dealers "with greater financial stability and operating advantages in such areas as data processing, telecommunications, advertising and marketing." He predicted continuation of the trend toward consolidation and diversification.

"However," Mr. Shad said, "given the large number of firms, the personal service character of the industry, the rapid growth of discount

brokers and the well above industry average returns on equity being reported by the regional firms, there does not appear to be cause for concern. To the contrary, these trends afford the prospect of sorely needed, greater financial stability within the industry."

The Chairman noted that significant progress has been made in the areas of market information dissemination and market linkage, as steps toward carrying out a national market system program.

In the area of current enforcement concerns, he said there is a continuing amount of evidence of significant abuses involving inside information by some within the industry.

"Given the great temptation to convert such information into personal gain, said Chairman Shad, "a rigorous enforcement program by the industry and the Commission is essential to discipline and deter such abuses. When insider trading is discovered, vigorous prosecution is essential, including imposition of severe criminal penalties where appropriate."

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