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THE ROLE OF FINANCIAL PUBLIC RELATIONS

An Address By

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I suppose there once must have been a time when the role of financial public relations officers was completely enjoyable and not terribly troublesome. Corporate earnings were up, new products were flooding the markets, investor participation in equity securities was brisk and companies generally had ready sources of capital available to use for corporate expansion. Time and the economy, however, have a way of changing things, and your roles are not exempt.

Today, the economy appears to be suffering from some malaise, and the securities industry definitely is, thus calling into question the capital-raising ability of the companies you serve and the securities industry we regulate. And, in these days of energy crisis, the fact that the companies you represent may turn a profit does not, of course, necessarily guarantee a return for you to the pleasantness and less trying days of by-gone eras. I can imagine, for example, the chagrin with which the financial public relations officials for our oil companies faced the rather dubious assignment of apologizing to the public for the profitable state in which these companies recently have found themselves.

Government regulation also has a way of breaking up the pleasant reveries of past glorious days. In those old days, corporate press releases and annual reports to shareholders were the principal means of disseminating corporate information to the public as well as to the corporation's own shareholders. Scant legal attention was then paid to most of these documents.

It was just ten years ago, however, that the Securities Exchange Act was amended to require the registration, under that Act, of the equity securities of companies that were not listed on any national securities exchange, if they were held by at least five hundred persons and the issuer had at least one million dollars in assets.

Prior to that time, the provisions of the Securities Exchange Act relating to the filing of periodic reports and proxy solicitations, as well as certain other matters, applied only to companies whose securities were listed with a national securities exchange. The '64 Amendments extended these provisions to virtually every company in the country that had any substantial public investor interest.

Since this expansion of our jurisdictional reach, we have been engaged in a steady expansion of corporate disclosure requirements, and the rules of the game, particularly in this era of expanding litigation under our general antifraud rule, Rule 10b-5, have also experienced a concomitant expansion. It might be said that we are still catching with up the significance of the enormous expansion of our federal laws as they relate to continuous disclosure. Why do we continue to place such emphasis on expanding corporate disclosure? Where are we heading?

One of the primary functions of our capital market system is to allocate capital in a fair and efficient manner. The continued availability of material corporate information is essential, in my view, to the refinement and maintenance of efficiency in our markets, an effort in which you play a major role. The underlying economic principle being that, in a free economy, capital will flow to where it will be the most profitable and, therefore, in the long run the most productive and useful, and that the decisions of many individual investors as to where capital will flow are better, overall and in the long run, than decisions made by an official body, however expert. It is not surprising, therefore, that, in his recent report to the

Treasury Department, entitled, "Public Policy for American Capital Markets," Professor Lorie reiterated the important need for a continual flow of corporate information for the efficiency of our capital markets.

The 1964 Amendments that thus extended the Securities Exchange Act to apply to American industry at large, led Milton Cohen, a Chicago attorney who had been the Director of the Commission's Special Study of the Securities Markets in the early 1960's, in addition to his other great achievements, to write an article in the Harvard Law Review, exploring the significance of the changes that had been made and suggesting that the time had come to concentrate upon a continuous disclosure process and, incidentally, to take some of the pressure off the single event of the registration of a public offering of securities.

He pointed out, in a most compelling fashion, that we had been providing elaborate information and protection to persons who purchased issues that were registered for public sale under the '33 Act, while we were under-informing and under-protecting persons who participated in our ordinary trading markets, a rather severe indictment, in view of the fact that the latter investors were and are, by far, more numerous and

more needing of protection. He also pointed out that, if the continuous disclosure system worked properly, Securities Act registration requirements could be met in large part by relying upon the regular disclosures made pursuant to the Securities Exchange Act and that the ordinary registration statement for the public distribution of securities could be a much simpler and less expensive document. Most of our thinking since then has been strongly influenced by these observations.

This integration of the disclosures in 1933 Act registration statements with 1934 Act reports has been manifested in new "short" registration forms, such as the S-16 and S-14, which permit '33 Act registration by incorporating '34 Act reports and proxy statements. This program has also greatly improved the disclosures made in 1934 Act reports. Annual reports required to be filed with us on our Form 10-K, which once served as a kind of adjunct to the annual report to shareholders, were amended in 1970 to expand the type of information required to be filed.

More recently, we have attempted to improve disclosures relating to financial statements -- principally, we have tried to make them understandable. The Commission has been moving to require financial statements that contain more information that will be useful to investors and their advisors.

Those of you who have responsibilities relating to stockholder relations in the furnishing of information to investors and publicly-owned companies, paid, I hope, particular attention to the Commission's recent release proposing to amend our rules to require that certain additional information be included in the annual reports companies subject to our proxy rules send to their shareholders.

Specifically, we have proposed that annual reports to shareholders contain information describing the general nature and scope of the issuer's business; disclosure of the contribution of a company's various lines of business to the company's sales and earnings; a five-year summary of earnings; information indicating the nature and scope of the liquidity and working capital requirements of the issuer; at a minimum the name and principal occupation or employment of each director and executive officer; the identification of the principal market in which the company's securities are traded and the high and low prices for each quarter over the most recent two years, together with information as to dividends paid and a statement of the company's dividend policy; and a statement that the company will send a copy of its annual report on Form 10-K to any securityholder on request.

In addition, we have proposed that financial information and data of financial highlights in the form of charts, graphs, figures and the like, do not present the results of operations or other financial information in a light either more or less favorable than do the financial statements included in the annual report to shareholders. We also would put an affirmative burden on the company, when it solicits proxies, to determine from the recordholders of its securities the number of beneficial owners of those securities and to provide sufficient copies of its annual report to shareholders as well as the other proxy materials to the recordholders on request, in order to permit the recordholders to provide copies to each beneficial owner. The company must also agree to pay the reasonable expenses incurred by the recordholder in transmitting these reports and other material.

Despite some reaction to the contrary, these proposals are not really very startling or revolutionary. At least, I imagine that a reasonably intelligent person looking at our financial laws and folkways for the first time, instead of being surprised at our proposals in this recent release, would be most curious as to why it took an agency, which frequently flaunts its devotion to disclosure, forty years to

get here. It might be a little difficult to come up with a convincing explanation, but to those of us who have been living through the process for many years, we realize that the matter is deeply affected by limitations in our statutory authority, fears of liability on the part of corporate management, resentment and resistance to the government intruding in the flow of communication between corporate management and its shareholders, and some substantive disagreement on the merits of some of the specific matters proposed.

We are, in effect, intruding upon the last and most important means through which corporate management annually communicates to its shareholders, and to the investment community at large, the information and ideas that it thinks they should have, in the form and manner in which management would like them to have it.

We are intruding and, then again, we are not. We are not proposing to make the annual report to shareholders a filed and processed document. While we propose to require that certain additional information be included in it, we are not proposing to mandate the exclusion of anything else that management wants to say, save only that it not be false and misleading. We are sticking to the position that the

annual report to shareholders is not, generally speaking, proxy material, although management can, by intent or inadvertence, cause such an annual report to become proxy material in certain circumstances.

But we are still faced with the question that has puzzled the Commission for forty years. How do we get the information spread to the persons who need it in a form in which they can use it? We have made some progress in making the official forms or reports filed with us available. Copies in the form of microfiche can be read, and hard copies procurred, both in Washington and in some of our regional offices. There is also a service for supplying these by mail upon request at a small charge. We should be able to improve this system shortly. But we will probably never be able to put the official Form 10-K, or the 10-Q's, or the 8-K's, in the hands of the ordinary investor or the ordinary registered representative discussing a purchase or sale with the ordinary investor with anything like the efficiency that is accomplished by the corporation's own annual report to shareholders. What should we do? We want completed accurate information spread abroad as widely as possible to be available to anybody interested in it and on the other hand we do not want to impose upon companies of all shapes and sizes unreasonable trouble and expense, and we don't want to impede the flow of communication from management to its shareholders.

It is tempting to require that, as the condition to soliciting proxies or the furnishing of an information statement, complete copies of the 10-K be sent to all shareholders along with the company's own annual report to the shareholders. This would certainly do the job, and in fact a few companies have decided to use their Form 10-K's as the bulk of their own annual report to shareholders. For companies that wish to do this, we are prepared to be relaxed and accommodating on matters of form and order or presentation. A few companies have simply included the Form 10-K as an appendix to their annual report. Others have offered voluntarily to furnish a copy of the 10-K to any shareholder requesting it, sometimes with a charge calculated to be less than the charge that the shareholder would have to pay if he ordered the hard copy through our regular service. If all companies were prepared to do this, it would certainly solve the problem of dissemination. But all companies are not so prepared, and, contrary to popular opinion, we do have some consideration for expense. Because of such consideration, we have not proposed requiring the mailing of the 10-K to all shareholders but only that the information in the annual report to shareholders should not be inconsistent with the information in

the 10-K in any material respect and that certain additional information be included. At this stage in the development of our continuous disclosure system, this seems to us like a reasonable compromise.

I think one criticism that could be fairly placed upon the Commission over the years has been that it has not been as imaginative and aggressive as it could be in getting information out where it belongs. We have been diligent about getting information furnished to us, but we have perhaps been too indulgent of the conceit that if we know it, everybody knows. As a matter of fact, this is obviously not true, and we should do more about it. Needless to say, we also should not rely solely upon official, mandatory documents for filing and circulation. The best communications system we have in this country is through the various media and the voluntary dissemination by corporations. Much of this is in your hands and the obligation to keep the American investor properly informed with respect to his securities is in large part upon your shoulders. In this regard, I urge you to take your professional responsibilities for public information seriously. I am sure that it comes naturally to think that my job is to promote my company and get its stock price up higher, but I hope it is now obvious to all of you that this is the

road to disappointment if not to prison.* Honesty, frankness, and completeness -- telling the man whose money is at stake the whole story, the good with the bad -- is the proper guide for today. No other way will work for very long. Any other way is frought with dangers to yourselves as well as to your clients.

Much of the development of the law on adequate responsibilities to insure fair and equal dissemination of material corporate information has been left to litigation under Securities Exchange Act Rule 10b-5, our general antifraud rule. In the last decade, there have, perhaps, been almost as many cases litigated under the one rule as under all of the other provisions of the federal securities laws combined. Of primary concern in Commission enforcement actions under that rule are the questions: have corporate officials selectively disclosed material corporate information to a limited number of analysts or other small groups of interested individuals; or have those officers themselves acted in the market upon material corporate information that has not been publicly disseminated? It should not require very much elaboration to state that both of these practices are viewed by us as being within the ambit of Rule 10b-5, and are unlawful.

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* SEC v. Pig 'n Whistle, U.S.D.C., N.D., Ill., Feb. 1972.

While the impact of many of the court decisions in this area as well as the institution of Commission actions under Rule 10b-5, has generally been salutary in causing corporate officials, securities analysts and other securities professionals to be more aware of their responsibilities under the federal securities laws, there are developments, which, in the long run, may prove undesirable.

For example, I recently received a letter from the managing editor of the Dow Jones News Service who expressed concern about the increasing number of publicly-owned companies that are refusing to give interviews to his reporters, based on the belief that such interviews are opposed by the Commission. In his view, this apparent drying-up of corporate information will have little effect on institutional investors, since they usually have other sources of information. The small investor, on the other hand, who has no other independent source of information, may be affected adversely by this trend.

Contrary to the impressions some companies may have, we have encouraged companies to make information generally available to investors and, in this connection, we have not attempted to discourage companies from discussing their affairs with responsible reporters or analysts. We do become concerned, of

course, when investors are given misleading information, or when some persons receive material information concerning public companies that other investors are unable to obtain.

Many companies have adopted policies designed to prevent violations of Rule 10b-5. Thus, for example, some companies limit discussions of their affairs with outsiders to conferences in which members of the financial press are limited, and some companies permit only certain of their officials to discuss the company's financial affairs with outsiders -- presumably persons who know what is happening in all aspects of the company's affairs and know what facts already have been made available to the public. Recent court decisions and settlements entered in Commission enforcement actions should spur other companies to adopt such guidelines. You can find those guidelines in the reported cases of SEC v. Lum's, Inc.* and SEC v. Liggett and Myers, Inc.**

I sense, however, that there is an increasing reluctance on the part of corporations to discuss their business activities with securities professionals, such as analysts and investment

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* CCH Fed. Sec. L. Rep., Current, ¶ 94,134 (S.D.N.Y. Sept. 13, 1973).

** Id. ¶ 94,204 (S.D.N.Y. Oct. 24, 1973).

advisers, as well as reporters. The prevailing attitude appears to be "why risk it -- the less said, the less likely it is that a violation of Rule 10b-5 will occur." Whatever logic may appear in this reasoning, this attitude is neither necessary nor healthy -- particularly at a time when efforts are being made on many fronts to induce small investors actively to participate in the equity markets.

To a significant extent, of course, the successful implementation of the continuous disclosure system we seek, which is aimed at keeping the trading markets informed, is dependent upon the existence of effective communications between the company and its shareholders, often through the conduits of the press and financial analysts. While the primary responsibility for the production of this information rests, of course, upon the issuers, everyone who participates in the process of getting this information to the public assumes a certain amount of responsibility for its adequacy and accuracy, the degree of which is dependent upon the particular circumstances.

With the proper understanding of the spirit and intent of the federal securities laws, those engaged in stockholder and investor relations and the dissemination of corporate information can be the best friends that the Commission can possibly have and that the American investor and his corporation can have.