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THE ACCOUNTABLE REGULATOR

An address by

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With this talk, I close my chairmanship. These four years have been a most remarkable period in which to serve: They have been marked by the greatest challenge, excitement, and opportunity in the securities field in the last half-century. We have witnessed unprecedented trading levels; the laying of a groundwork for a national market system; the burgeoning and legitimization of the takeover; the beginnings of effective self-regulation for the accounting profession; a reexamination of corporate accountability mechanisms; and the return to the securities industry of an innovative and publicly beneficial entrepreneurial spirit -- as exemplified by the growth of the money market funds, the options markets, and discount brokers.

More than any other factor, however, what has made these times so challenging -- for me and for most other regulatory officials -- is external to the nature of the particular matters under our jurisdiction. It is the persistently low level of confidence in our societal institutions, public and private alike. The consequences that could arise when a society substantially loses faith in its institutions are, simply put, frightening. They conjure visions of a people whose social fabric has begun to unravel.

What is needed to restore public confidence, I have long believed, is a rethinking and changing of our social dynamics -- and, in particular, those involving society's two

predominant actors: business and government. To this end, the lodestone of my chairmanship has been an effort to enhance the strengths and foster the sensitivity of both business and government so that they might serve as more positive forces in meeting society's needs and expectations. Each, I believe, has virtues and responsibilities without which these objectives cannot be achieved.

Business, after all, is the only available source of the productivity, jobs, and real wealth which we need to underwrite our economic aspirations and humanitarian principles. And, only free enterprise can provide the decentralization of power and the diversity in addressing national needs that are the prerequisites to maintaining a free society. I have often referred, in this vein, to the teaching of one of my predecessors, Justice William O. Douglas, that "the First Amendment and free enterprise...go hand-in-hand in a practical way."

Government also has a critical role to play in this system as the representative and advocate of the public interest and, when necessary, as the enforcer of legitimate societal needs to protect its health and welfare. The Commission, in essence, provides the constructive tension necessary to prevent self-regulation from lapsing into collusion, as well as the discipline to prevent or correct publicly threatening excesses.

This is a view that has led me to become, at times, an admitted critic of both government and business whenever I have believed that either was contradicting its obligations to the Nation -- whether out of insensitivity or out of selfishness. Hopefully, I have acted with the spirit of what John Gardner has called "loving criticism." What is missing from society, in my view, is not merely criticism; not merely blind defense and love; but balanced, loving criticism in the most constructive and caring sense.

Thus, it was not my interest in the securities field alone which led me to the Commission. I accepted the challenge largely because of my belief that the most urgent crisis before this Nation is this lack of institutional credibility. I recognized that the SEC and those that fall within its jurisdiction, taken together, are an important -- and perhaps most significantly -- workable corner of the economy. Our particular government-business relationship, in my opinion, could and should be an example of what a thoughtful government regulator, and industries and professions with traditions of public service, can achieve together.

The purpose of my remarks tonight is neither to solicit complements nor suggest that all that could be accomplished has been. Rather, I seek a broad commitment to a continuing improvement of the regulatory system.

This is a goal, I should emphasize, whose accomplishment has not been made inevitable by recent election results. Whatever the party in power, whatever the administration, over the last decade and a half our economic problems have accelerated; and the momentum of the regulatory process, while possibly no longer accelerating, has not yet been reversed. Regardless of the philosophical bent of those in office, formal governmental regulatory systems can be dismantled only to the extent that the public's reasonable expectations of private sector performance and conduct could be, with reasonable likelihood, otherwise satisfied. Conversely, if the private sector itself does not provide an environment which fosters public trust and confidence, no political officeholder could insulate it from the consequences. Prominent legacies from the last avowedly probusiness administrations, it should be remembered, include the current AT&T anti-trust case, a revitalized Federal Trade Commission and the questionable payments program.

With this in mind, tonight, I want to review our collective successes, our shortcomings and our continuing challenges as compared against a vision of improved regulation. This talk will be divided into three sections: First, I will offer a few words regarding the dynamics that have led to the erosion of public confidence in both the private sector and its government regulators. My point will be that a mindset of parochial self-interest and lack of public

accountability is -- for both equally -- not only damnable but in the long run damning. Next, I will examine the responsibilities borne by the Commission for achieving a rational, effective and efficient regulatory system. And, I will review some of the decisions we have made in recent years to further this end. Finally, I will consider the private sector's responsibilities -- with a special emphasis on those of the bar -- in responding to such efforts.

REGULATORY ACCOUNTABILITY

At the outset, let us look to some general principles regarding the importance of public accountability and how failings in accountability have affected our society. A sensitivity to its accountability responsibilities is as important to the regulator as it is to the corporate official.

It is, first of all, an axiom of democracy that all centers of power should be accountable to publicly acceptable standards of conduct. A free society cannot tolerate over time power employed capriciously or inconsistently with the public good. Some of society's expectations of how power should be exercised are expressed as laws. In a healthy society, however, many others are not so explicitly stated. That does not mean, nonetheless, that any conduct not legally proscribed, therefore, constitutes an acceptable course of action. Rather, conduct which is fashioned to comply only nominally with the law merely invites, if the public's expectations are breached,

more detailed and prescriptive law and regulation describing what is, and what is not, permissible behavior.

A society of such detailed and prescriptive laws, however, would not necessarily be a more moral society. For, technical compliance with the law to avoid penalty should not be confused with moral behavior. And, a society which needs the law to articulate and enforce all moral behavior has lost its ethical bearings. Nor, would it be a more productive society, for nothing hampers creativity and ingenuity so much as a highly structured, inflexible system governing conduct.

I expect that many here this evening have heard me express this theme as I have advocated greater corporate sensitivity to private sector accountability responsibilities. These same dynamics also apply to regulatory agencies, which have taken on their own independent identities, interests and constituencies. They, too, are held accountable to public expectations of conduct in the exercise of their power. And, if they are perceived as breaching them, government regulators may be subject to the same brand of overbroad and counterproductive reactions as are often experienced by the private sector when it is perceived to be unaccountable. For example, abuses in revolving door employment policies in some federal agencies led to dysfunctional overreactive restrictions applied throughout the government under the Ethics in Government Act. In short, Congress holds a

legislative club over the regulators in much the same manner as it does over the private sector -- and often uses it just as poorly.

Such a system, however, is not very satisfying. Intelligent and prudent regulation has an important role to play in providing meaningful safeguards to the public's health and welfare. But, what often is missing from the regulatory dynamics which I have described is the likelihood of substantially improving society. The collision of parochial interests among public and private institutions does not necessarily produce a composite truth, and overreactive legislation to penalize unaccountable conduct -- whether private or public -- may result in a more legalistic society, but not likely a better one.

I prefer a different model of government: a system which, in my opinion, will better serve all elements of the public. It is a model in which a government agency does not pursue its parochial interests to the extreme; but in which the agency understands the importance of a healthy private sector and appreciates government's limitations as well as its responsibilities. And, it is a system in which private institutions respond meaningfully and constructively to the societal interest and this regulatory posture.

But, it is a model which, it must be noted, incurs certain risks. If the private sector's response is not

constructive -- and if it uses legalisms and technicalities as a shield to avoid accountability -- this alternative regulatory system will not succeed over time. And, such failure would only serve to strengthen the position of those who advocate ever-greater government intervention and regulation of our economic engine.

THE COMMISSION'S INITIATIVES

Let us now consider the Commission's actions during the last four years in light of this regulatory model. Of course, I do not suggest that every Commission decision made during this period has proved to be the most ideal possible course of action. But, I am proud of the Commission's commitment to being a judicious and balanced agency -- or, in other terms, an accountable regulator.

For its part, the Commission has suppressed the urge to extend its domain to its farthest conceivable reaches. And, we have acted to avoid and reduce the type of detailed and pervasive regulation that unreasonably intrudes into the private sector.

Indeed, we have tried to act with the humility and restraint that are the responsibilities inherent in the exercise of great power. The vesting of regulatory authority in an agency, we appreciate, does not commission it as the exclusive depository of wisdom or morality or as the sole

oracle of the public interest. To think otherwise, in my view, would be as dysfunctional as it is inaccurate.

In a setting in which any decision of consequence is subject to a governmental standard of conduct, literal compliance to the standard -- rather than any principles of ethics or individual responsibility becomes the measure of acceptable conduct. And, in such an extreme situation, the ethical health of a private individual or institution -- that is, the ability to identify and respond to internally generated norms and not merely to conform to externally imposed standards -- would be largely unexercised and unreinforced and, therefore, would atrophy over time to a state of amorality.

We have recognized, therefore, the need for private sector diversity. And, we have recognized -- indeed encouraged -- considerable discretion for those who, in good faith, seek to comply with the spirit of the law.

Further, we have appreciated that the interests of the greater society must supersede parochial institutional interests. The ultimate purposes of the federal securities laws are, after all, to ensure the confident, efficient, and fair markets that foster the capital formation which underpins our prosperity and democracy. In this light, while the federal securities laws speak specifically only to the former, investor protection and capital formation are

not inconsistent objectives. On the contrary, when they are properly balanced, they go hand-in-hand. Adequate investor protection enhances the confidence and willingness of the public to invest, while healthy capital markets provide the fuel for a growing economy and offer investors a fair and efficient marketplace for a broader range of suitable investment media.

To achieve this balance, the Commission is dedicated to enhancing those of its activities which are central to ensuring honest and healthy securities markets -- such as its inspection, market surveillance, and enforcement programs -- while, at the same time, the Commission recognizes its responsibility to accept regulatory risks and balance competing interests so as not to seriously discourage legitimate investment and commerce in the name of investor protection.

In many respects, the regulatory laws administered by the Commission can be placed on a spectrum according to their detail and pervasiveness. At one end of the spectrum would be placed the Investment Company Act, a statute which may well be second to none in its minutia. The challenge, in these circumstances, has been to reinstill diversity and flexibility into what had become a stilted regulatory system. At the other end of the spectrum would be placed such matters as corporate accountability in which the public has

important concerns, but for which there is no existing regulatory system. The challenge, in this situation, has been to address those concerns effectively in a manner which avoids and prevents the imposition of federal legislation.

Let us briefly examine, with these attitudes and objectives in mind, how the Commission has fashioned a number of its major programs.

The National Market System. The high esteem in which the Commission has been held is, at least in part, attributable to the nature of its traditional regulatory objectives: Its key mandates -- that is, its unique corporate disclosure and self-regulatory oversight programs -- are rational and achievable objectives. Historically, we have been largely uninvolved in substantive economic regulation or in balancing competitive interests. Indeed, it was not until the 1975 Amendments directed the Commission to facilitate the development of a national market system that the Commission was placed in a substantially promotional role. And, not coincidentally, this has been the role in which the Commission has felt least comfortable.

The mandate regarding the National Market System which the Commission received is not without ambiguity. The Commission could have interpreted the 1975 Amendments to authorize it, in effect, to take active command in

restructuring the nation's capital markets -- indeed, in some quarters the Commission has been criticized for not doing so. But, we recognized that such a reading clearly would not have been in the Nation's best interests: Frankly speaking, we do not have the wisdom or expertise to design a national market system. And, the capital markets are too important and too fragile to be subject to the whims of inexperienced planners. Common sense, if not the national interest, required us to proceed prudently -- even if, to some, that meant a pace slower than they would have desired.

We have, as a consequence, exercised our national market system responsibilities in accordance with our traditional oversight mode: We have expedited, criticized, encouraged, and cajoled; and, we have avoided becoming the planner of first instance. And, while important work remains, all in all, substantial progress has been made in achieving the objectives of the Act without adversely affecting the functioning of the markets or the confidence of investors.

Disclosure Policy. I noted a moment ago that our disclosure mandate is an achievable objective; but, I do not suggest that it is an easy one. The financial impact of a number of developments -- from inflation to questions of management integrity -- raised important and difficult disclosure questions over the last four years. In addressing these questions, the

Commission, in my view, restrained itself from merely reflexively burdening financial reporting with new requirements that would lead, at most, to marginally useful boilerplate, vexatious litigation based on novel theories of liability, or disclosure intended more to substantively modify corporate practices than to inform investors.

The Commission, instead, is in the process of integrating its two disclosure systems -- that is, its 1933 Act and 1934 Act requirements -- in order to simplify these reporting requirements, and, perhaps most importantly, facilitate an issuer's getting to market in a timely and efficient manner. And, in reviewing our disclosure standards, the Commission is emphasizing the most useful information, even if it is so-called "soft" information. Often, that has meant fostering private sector innovation and allowing experimentation; even, when necessary, establishing safe-harbors.

Financial Accounting Standards Board Statement No. 33, regarding the effects of changing prices on a company, is an example of such an innovative approach to disclosure. Statement No. 33 is not held out as a definitive standard on inflation accounting. Instead, it represents a recognition that the state of the art does not permit a definitive standard and that, at such times, the urgency of the need

for enhanced disclosure is such that one must begin the process and still allow for the experimentation that is the only practical source of necessary experience and empirical data on which to build a better standard.

The Investment Company Act. The Investment Company Act is one of the most extreme of our major regulatory acts in terms of the degree of constraint that it imposes upon an industry. Moreover, the gloss placed on the Act by the Commission's interpretations had made it even more cumbersome. For example, though the Act did not expressly prohibit a fund's bearing distribution expenses, such a proscription was said to be implicit. And, under this type of mindset, such normal commercial matters as nonfraudulent advertising became a matter of routine Commission deliberation.

Our response, these last four years, has been to refashion this regulatory system to remove the federal government from such routine business decisions and to place the authority -- and the responsibility -- for these matters where they belong: on investment company managers and directors, especially independent directors.

Accounting Self-Regulation. Given the importance and public nature of the accounting profession's work, it is clearly imbued with a public interest. Accordingly, over the nearly 50 years since the enactment of the first federal securities

laws, the federal government has played a sometimes restrained -- but nevertheless always attentive -- role in the activities of the profession.

At no time, however, has that interest run so high as during the last decade, when much occurred to challenge the credibility and trust which the profession has cultivated and enjoyed. For example, the relevance of traditional accounting principles has come into question in our chronically inflationary environment. And, we witnessed the collapse of major corporations on the heels of financial reports, reviewed by respected auditors, which did not communicate the threat of impending insolvency. Further, revelations of off-book payments to foreign officials, political candidates, and others caused, among some, doubts as to the effectiveness of the profession's work.

Rather than seeking a legislative remedy to those concerns, the Commission counselled Congress, instead, to encourage and foster the accounting profession's own constructive response. And, to further this objective, the Commission accepted the responsibility to monitor and evaluate the profession's efforts to meet its challenges.

Substantial progress, in fact, has been made in developing more meaningful and coherent accounting standards, as well as developing potentially effective -- though, in some important aspects, still untested -- self-regulatory

programs. And, what has been achieved has been done without the enactment of legislation which could deprive accountants of their status and responsibilities as an independent profession.

Corporate Accountability. No issue addressed by the Commission during these last four years aroused the passions of commentators so much as corporate accountability. Many thought the Commission's and my interests in the subject were intended to seize expanded regulatory authority; others viewed them as a conscious prelude to enacting federal corporate legislation.

In fact, these concerns were misplaced. We have taken important actions, all well within our jurisdictional prerogatives, to enhance certain corporate accountability processes -- such as improved mechanisms for shareholder communications and voting. But, the Commission has left the initiative to resolving questions regarding the structuring of business enterprises where it best belongs, within the domains of private sector responsibility and decisionmaking.

As many here know, my personal role in the corporate accountability debate has been to urge the business community to be more sensitive to their accountability responsibilities, while explaining to public policymakers the impracticability and societal costs of attempting to legislate federal accountability standards. And, I believe that this voluntary

approach has proven warranted. Substantial progress has been made to improve the structure of corporate accountability. For example, the Commission's most recent survey found that 65 percent of directors of public companies are not part of the management of the companies they direct and that 85 percent of public companies now have audit committees, a number that is much higher among major companies. And, another recent study indicates that one-third of internal auditors now report directly to the board -- while many others have direct access. The key now, of course, is whether these important structural reforms will translate into the sensitivity and effective decisionmaking necessary to satisfy the societal concerns which brought the issue of corporate accountability into the public's eye. I believe that they can, and I trust that they will.

THE PRIVATE SECTOR'S RESPONSE

The common theme of the various Commission positions that I have outlined so far is their intent to facilitate and encourage private sector initiative and diversity. But, concomitant with the transfer of decisionmaking latitude back to the private sector must be its acceptance of the duty to ensure that the substance and spirit of society's interests will be satisfied. And, if this responsibility is not met, the result inevitably will be to revert back to --

indeed, increase both the credibility and the scope of -- traditional systems of detailed, pervasive regulation. My basic point, in short, is that all players in the system must do their jobs in a conscientious and credible way.

This evening, given the nature of this gathering, I will focus specifically on the importance of the lawyer in fashioning a constructive regulatory environment. Indeed, in many ways, this type of regulatory system places great emphasis on the role of the lawyer. His responsibilities -- and his influence -- in the regulatory process should not be underestimated. In effect, the lawyer sets the tone of compliance. Deference is given to his expertise in what is often viewed by the layman as an arcane exercise. Because of this role in compliance decisions, the lawyer becomes, in essence, a corporate policymaker -- even if neither the lawyer nor the client consciously intended that result.

There are, of course, some lawyers who bring to this task the sole mindset of avoiding potential liability. The minimum possible level of literal compliance with the law is their objective. After all, to such a mindset, the addition of further meaningful description, even though it may be useful to investors, could turn out, over time, to be a source of embarrassment or even legal action. And, that which is disclosed may not always be very intelligible or illuminating; as a result of being drafted with an exclusive

eye to litigative concerns and little thought to informing investors.

I do not minimize either the importance or the difficulty of the lawyer's effort to steer his client away from potential liabilities. That is, undisputably, a major responsibility to the client.

Yet, my sense is that most of the bar appreciates that the lawyer must not limit his objectives to merely insulating his client from liability. The sophisticated lawyer does not ignore the existence of potential liabilities; but he recognizes that the client's best interests are not served when actions must be fashioned according to inappropriate or sophistic concerns.

Indeed, the Commission deserves the same substantial degree of credibility and deference in its own decisionmaking that it is extending to the private sector. The Commission's record over the last few years, in my opinion, evinces an attitude of prudence and common sense. Clearly we are defending, in a most aggressive manner, the integrity of the securities markets. However, we seek neither to substitute our judgment retroactively in place of good faith decisions by the private sector nor to expand our domain beyond meeting our statutory responsibilities effectively and forcefully.

Let me amplify on these thoughts in the context of a recent, significant Commission innovation: the annual

report's new disclosure item on management's discussion and analysis of the company's financial condition and results of operations.

The latitude in disclosure provided under this item allows it to reach the almost infinite variety of concerns that may be of importance to one or another industry, type of business, or set of circumstances -- matters of which the issuer and its counsel are the most likely to be aware and and best qualified to appreciate the importance. The issuer knows what is important. Indeed, this item has been intentionally structured so that disclosure will be fashioned by the issuer rather than forcing the issuer to fit uncomfortably into a pre-established regulatory mold.

I hear, however, of many instances in which material prepared by managers and accountants in response to this vital item has been restrained by their lawyers. Counsel, apparently fearing some degree of risk for descriptions or projections prepared under this item, have edited what others considered to be meaningful disclosure down to lesser levels. If this be so, they are hampering, instead of fostering, compliance with the spirit of the law.

The risks of harm to the client from such a narrow viewpoint are threefold. First, as I noted earlier, the classic regulatory response to minimal, technical compliance with the law is increasingly detailed and pervasive standards.

In short, regulatory innovation in which the client may have a very real stake is placed at risk by such a restrictive approach to the law. And, additionally, the client loses a potentially meaningful channel for communicating its story to the investing public. Indeed, more and more investors have come to recognize the usefulness of such information in understanding a company's condition and operations. As a consequence, its very absence may prove conspicuous to the markets and may be having an adverse effect on the acceptability and value of the company's securities. Finally, the lawyer who limits disclosure to avoid liability may, as an ironic result, find his client subject to charges that the item's disclosure obligations have not, in fact, been satisfied.

CONCLUSION

In conclusion, this evening I have described the model of accountable regulation toward which I have worked. It is a system which seeks to replace government edicts, and allow -- indeed, require -- the private sector to establish its own standards of acceptable conduct. Importantly, it is the system which, in my view, best holds out the promise of a healthier economy and society, rather than just a more legalistic society.

At the outset of this address, I noted that it largely was the character of the Commission and of those with whom

it interacts which led me to believe that a more constructive government-business relationship can be developed in the securities field. The last four years have served to confirm this judgment.

The Commission's staff, simply put, is outstanding; it is a tribute to what a meritocracy can achieve in government. Its members have appreciated the need for regulatory reform. And, they have had the intelligence, creativity and sophistication to fashion Commission initiatives and to enforce securities regulations in the most appropriate manner and in the highest traditions of this unique agency. I am proud of them and honored to have been associated with them.

And, those in the private sector, on the whole, have responded to the Commission's initiatives in a most responsible and constructive manner. Most have shown an understanding and a commitment to the necessity of maintaining an appropriate Commission presence in protecting the integrity of the securities markets. And, they have accepted their responsibility often most creatively and positively. As common among people of goodwill, we have, at times, disagreed, but my sense is that there is a remarkably broad consensus on common objectives -- even at times when self-interest is strong enough to prevent or discourage full responsiveness.

The result has been, to my mind, an exciting experiment and a great adventure. I thank each of you for having made it so much fun.