SECURITIES AND EXCHANGE COMMISSION
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DISCLOSURES AND CORPORATE MANAGEMENT

An Address By

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Government officials are prone to stress how their actions are made mandatory by act of Congress, when they are doing something unpopular or explaining themselves to persons who find their actions expensive or otherwise painful, or to stress their lack of legal authority or resources -- bureaucratese for paucity of budget or having spent it the wrong way -- when criticized for inaction. In any particular case, one of these excuses may be quite correct. But they can be, and are, overdone. All government agencies have some discretion -- and we at the SEC have a good deal -- with regard to how we spend our time, what views we take of the law, what rules we adopt, what policies we follow, who we sue or don't sue.

In exercising this relatively broad discretion, good jurisprudence presses us to be reasonably systematic and consistent. While maintaining the capacity to temper justice with mercy, to exercise judgment rather than logic, and to concentrate on the major problems rather than scatter ourselves equally on all fronts at the same time, we strive to proceed in an orderly way, to provide a reasonable degree of predictability for our actions, and to avoid even the

appearance, much less the reality, of acting on whim or -- what is worse -- acting to court favor for political or personal purposes. This is not always easy. The development of policy within the Commission has its own dynamics and may generate a momentum that is difficult to stem before it leads to excess. In these hypersensitive times, any variations in enforcement actions or positions taken, which show some interpositioning of human judgment rather than the product of a well-programmed computer, raise suspicions of favoritism of one sort or another. In this atmosphere of Watergate fall-out, it takes some courage to decide not to sue someone against whom you have a plausible case, lest you be charged with one more cover-up. Nevertheless, our discretion is real and broad in all of these respects. Because we can act otherwise than the way we do, we must develop policy, consciously or otherwise, and accept responsibility for the consequences.

These are not easy times in which to do this. One gets at the same time too much guidance of a conflicting, contradictory sort, and too little in the form of clearly accepted standards and goals. In recent years, much public

attention has been devoted to our struggling with this process in relation to the securities industry and securities markets. This evening I would rather say a few things concerning the development of policy toward the uses of disclosure and their influence on corporate management.

The general attitude toward business, both within and without the ranks of government, is variegated. I grew up in a period when the dominant, or at least the most strident, intellectual attitude was opposed to private -- in the sense of non-governmental -- control of economic activity. Formal, classical communism was within the pale as were various gradations of socialism, all positing the domination and direct control of production and distribution by the state. During that time, one could at least say the fundamental lines were rather clearly drawn. Early in this period the SEC was conceived unequivocally on the side of private control. While its conception was unfriendly to business, or more especially financing and securities trading, as then conducted, it was uncompromisingly aimed at reform of the private sector, not its aboliton.

This is still our conscious mission. Certain current revolutionary groups which characterize the SEC as the allies of capitalist-imperialist pigs, are right. Our whole mission, while stated in terms of investor protection, is ultimately to make the system of the private ownership and control of capital work, and to do this through periods of great change in external conditions and popular attitudes. And, as a matter of fact, without the private ownership of capital, we would go out of business, having lost our reason for being. More than that, the acts we administer were all conceived in the same philosophy.

These acts also are based on the proposition that the private ownership of capital will work most efficiently, and survive the strongest politically, if the provisions of the act are effectively administered and enforced. The argument runs that people, individuals and non-governmental institutions, will not invest their savings in corporate securities unless -- in addition to an expectation of reasonable gain in yield or market price -- they are confident that they have access to adequate information, that the after-market in the

securities will be operated in fairness to them, and that the company whose securities they hold will be managed in their interests to an appropriate degree. There are a multitude of theories about why investors go into or out of the market, or buy or sell particular securities, but we think the propositions that I have stated are basic to them all.

There have been times when the Commission has been suspected and accused of crying wolf as to challenges to the system. Critics observe that virtually every repressive measure we have imposed or proposed has been grounded on the assertion that this bitter medicine is necessary to save our loved one, when the loved one did not feel sick or in any danger. Perhaps it has been overused in this respect. It can be a handy excuse to increase our authority. And excessive mothering can kill the baby. The possibility of these excesses always exists, but let us look at the present situation and current developments.

The first and most fundamental intrusion of the Federal securities laws into the domain of corporate management has been the several requirements for making

information available to investors -- information about the company and its operations, and information about management itself, its holding of, and trading in, the company's securities, and transactions of management personnel with the company. These disclosures still govern one approach to, and handle on, corporate management for those thousands of companies (other than brokers and dealers) subject to the reporting requirements of the Securities Act and Exchange Act, but not subject to the more regulatory provisions of the Investment Company or Advisers Acts, or the Public Utility Holding Company Act. With minor exceptions, we have no authority over what these companies do, but only over whether and how they disclose what they do to the investing public.

We are fully aware, however, that disclosure, or the authority to require it, is a powerful weapon. This was well understood by the Congress in 1933 and 1934, and has been by them and us ever since. The normative role of disclosure has run all through these acts and their administration for 40 years. The disclosure of top executive salaries is not just of interest to the analyst but may also serve as a brake on excessive salaries. The same is true of transactions by

insiders or their affiliates with the company, and many other items. We understand very well that when we are considering the compulsory disclosure of elements of certain types of transactions, we are also considering on what terms they will occur and, sometimes, whether they will occur at all.

How to apply this powerful weapon today is a recurring matter for deliberation among us. When it comes to further disclosures of what might be termed regular, or traditional, financial and operating information, the question usually boils down to trouble and expense on the company's side weighed against views as to the usefulness of the information to investors. Reporting companies tend to regard any additional requirements of this nature as involving additional expense out of proportion to any conceivable utility to investors, who cannot assimilate or understand the information already available. The Commission, on the other hand, argues that the public disclosures must be sufficiently complete, as well as accurate, so that those who do want to know, can find out -- the individual investor who is largely limited to what is sent him, as well as the professional who has other resources.

The present controversy over quarterly reports and the role of outside auditors is, from the companies' point of view, primarily a question of expense. Some companies have expressed objection to what they deem an undeserved exaltation of the views of independent auditors over those of company officers, but most companies who have objected to our recent proposal seem to have been overwhelmingly concerned with expense. The objections of the auditors, themselves, have had a different focus -- they naturally tend to be more worried about their potential liability for some association with interim reports in the absence of adequate procedures and standards to govern their conduct.

While the auditors' argument may be curable, and the accounting profession is working on a cure, the companies' expense argument may not be, although the amount of the expense depends in part on what is expected of the auditor.

The argument that disclosure is expensive -- often joined with the observation that nobody reads it anyway -- is at least as old as the Federal securities laws themselves. On the whole, the Commission has been insensitive to them.

Partly because these considerations, if given too much weight, would defeat the whole process. Partly because of a conviction that material disclosures to investors are inherently worth whatever they cost, and partly because the amount of the expense, while irritating to company executives, has generally been small. This is a period, however, when much attention is being directed toward the overall burden of paper work which government imposes upon business, which adds unnecessarily to business costs and contributes to inflation.

Most of our disclosure requirements are intended for the benefit of investors, not of the Commission. This, we think, is an important point of distinction. Nevertheless, the widespread and proper concern with the costs of this general sort is leading us to a closer look.

There are several other developments outside those of traditional disclosure which raise more difficult questions of our relationship with corporate management. All of these involve countervailing considerations of a perplexing nature.

One of these is the general phenomenon which has been dubbed "going private." Since I take a somewhat less alarmist view of such transactions than some of my colleagues

and some of our staff and much of the public, I do not think the soubriquet, "going private," has contributed to careful and dispassionate analysis. Even so, it is with us, and we are engaged in a study and investigation of all such transactions that lead either to the elimination of minority interests or the reduction of trading or number of shareholder so as to destroy a liquid market or free the company from Exchange Act reporting requirements.

Views outside the Commission's ranks could hardly differ more sharply than those within. Expressions of outside opinion vary all the way from those of one responsible financial journal that expressed the editorial opinion that the Commission should stop "sucking eggs" and promptly halt these shameful rip-offs, to those, especially of lawyers' groups, who accuse us of having lost much of our virtue, and proposing to lose it all, by imposing substantive standards under a disclosure system -- something we have consistently refrained from doing.

New disclosures also are being sought in another area; these are what are coming to be called public interest disclosures. For some time, the Commission has been pressed by certain religious and self-styled public interest groups to require companies subject to our rules regularly to report on their conditions and conduct with respect to equal employment, environmental matters and some other matters, such as doing business in South Africa. The Commission has gone only so far as to require disclosure of employment and pollution problems that threaten to have a material adverse effect on earnings. This much, we thought, was clearly sustainable under our traditional approach. It has not satisfied the zealots.

Not long ago, one group which had been requesting further rule-making by us persuaded a Federal district court that, right or wrong on the merits, we had not given the requests adequate attention. Rather than contest the court's concurrence in these views, we decided to give the proponents of these disclosure requirements a full and public hearing-- a process that began this morning. The Commission goes into these proceedings with a well-demonstrated reluctance to start down this road

of a whole new rationale of disclosure, but one must accept the fact that we are endeavoring to keep our minds open, lest these hearings themselves constitute a species of fraud, and so we might in the end be favorably persuaded as to some or all of the proposals.

The advocates of these disclosures seek to fit them into the traditional approach of the Federal securities laws by fitting them into the informational needs of the so-called ethical investor, who cares about ethical, not just financial or economic, materiality. The apparent absence of adequate standards for determining ethical materiality satisfactory to investors in general, is one of the objections to adopting this rationale. Beyond this, however, it is no doubt the hope and expectation of these proponents that the need to disclose will tend to influence management to change the facts that would have to be disclosed. I don't mean to suggest anything improper in this. The need to disclose employment conditions and practices, for example, will tend to move management toward compliance with prevailing public opinion, in addition to informing ethical investors as to whether they desire to acquire or hold a company's securities. This is an accepted, if logically ancillary, role of disclosure.

While we are arguing over how far we should go toward informing these ethical investors on public interest matters, knowing that in so doing we may influence the conduct of corporate affairs, the Commission has never been wholly indifferent to the interest of investors in the ethical quality of management. Such obvious facts as prior convictions for financial fraud of officers and directors has long been regarded as relevant and material. This area of disclosure, however, has taken on a new urgency in our concern with what might be loosely called "management fraud." Here, we know we can accomplish good through the prophylactic effects of disclosure, but we are also faced, or will be, with serious quandries as to how far we should go.

The most dramatic instances of this sort of thing have been the political contributions and slush funds which came to light initially through the efforts of the Watergate Special Prosecutor and related activities. The threshold question in many minds is what business is it of the SEC and the Federal securities laws when a company makes a political contribution which may be clearly illegal but is equally clearly immaterial to the company in dollar amount?

First of all, that assumed state of facts is not what we have usually found on fuller investigation. What we have found, in a series of cases fully reported in the press, has been a pattern of regular contributions and expenditures for political or official influence, funded by laundered money -- rebates from overcharges to foreign subsidiaries or friendly companies or consultants who deposit the agreed amount in an account subject to the direction of whatever company officer is put in charge of the business. When these sums, as they have, aggregate some millions of dollars over several years, it is difficult to pass it all off as too small to worry about, even if the companies' revenues run to hundreds of millions. Obviously, this pattern also involves the systematic falsification of financial records.

Why have we thought it important to force the disclosure of these schemes? There are several grounds of varying weight in different cases.

It is central to our whole financial reporting apparatus that accounts not be deliberately false, even in relatively small amounts. Preserving the integrity of

financial reporting is one important objective. To the extent that the business of the company, or any segment of it, is dependent upon the making of illegal, and therefore necessarily secret, expenditures, the quality of earnings is obviously affected.

The degree of hazard injected by this clandestine and illicit underpinning may vary considerably from case to case, but we are not likely to be much swayed by arguments as to the improbability of getting caught, the widespread condonation of the practice in the relevant community and the apparent certainty that the company is getting its money's worth -- which may well be the case.

We think it important that the Federal government, through the Commission, not consciously cooperate in the cover-up of illegal and corrupt practices. We think investors ought to know that management engaged in these practices. This is, no doubt, as far as it goes, a recognition of ethical materiality, although it is likely seldom to be the sole consideration. And finally, we are by no means indifferent to the prospect of reducing the incidence of corrupt practices by forcing their disclosure, even though we have no direct responsibility for enforcement of these laws.

There are further questions in this area that we have not yet resolved. No doubt there is a point of immateriality even on this scale, although we have not yet located it in a live case. And the question of the related responsibility of outside professionals, especially auditors, is still being pondered.

On the whole, we hope the message of our actions against corrupt practices is getting across, and that the normative side effect of disclosure policy will improve corporate practices wherever deviation has developed.

We hear it asserted broadly today that business must be freed from the weight of excessive and regressive regulation and, at the same time, that private management of economic activity is losing its legitimacy through improper conduct by business leaders and lack of responsiveness to the public interest and the interests of investors. In appropriate cases, the proper conduct of disclosure policy can be the least oppressive and most effective means of achieving both of these goals and we propose to conduct such a policy.