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SEC--CATALYST FOR COMPETITIVE FREE ENTERPRISE

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I have been asked to give you a view from the Securities and Exchange Commission on disclosure requirements for multinational corporations, a topic which is presently demanding the attention not only of the SEC and the corporate community but of our State and Justice Departments, foreign governments, and the citizens of many nations throughout the world. Because the subject is fraught with controversy and since it is publicly known that there are differences of opinion among members of the Commission with respect to the type and degree of disclosure the SEC should require of public companies, I want it to be very clear that my remarks do not necessarily reflect the views of my colleagues at the Commission.

I am firmly convinced that the most effective method to maximize economic production is for government to provide an environment in which there are opportunities for individuals to obtain benefits according to their efforts and sacrifices. Moreover, experience has shown that a system encouraging the development and management of private capital and competition among business enterprises for that capital and other productive resources and also for sales on the basis of product, price, and service results in the most efficient use of resources.

However, the incentives to maximize profits or personal benefits can be so powerful that unless they are balanced either by high ethical personal and corporate principles consistent with the public interest or by external requirements to assure that certain standards are maintained, abuses will occur.

One of the elements of a free system is that by its very nature individuals are able to make choices and engage in activities which may be detrimental to their own interests, the public interest, and may even be destructive to the very system providing such opportunities. It appears from some of the newspaper reports that the scandals which have resulted from illegal and improper payments by international corporations have provided support for those in this country and abroad who oppose our free enterprise economic system. Commenting on the situation in Italy, one news article stated, "Most diplomats and other political analysts agree that the scandal has served to strengthen the Communists." Another article indicated that, "French Socialists found the corruption revelations a further reason for promoting their program of nationalization of multinational companies in France." Alleged payments in Japan have resulted in a political crisis and Prime Minister Takeo Miki in a letter to President Ford stated that if the payments issue is "kept unsolved with the names

of the officials involved remaining in doubt, democracy in Japan may suffer a fatal blow."

The situation is aggrevated by those who try to defend their improper practices by saying that, "Everybody's doing it," or "Any big company has to give bribes to stay in business today." One French official, who sees bribery as a normal part of commerce, is quoted as saying, "Why did the Americans have to publish this?" "They are really crazy." Others have stated that "the fuss about bribery is naive."

The suggestion that corruption is a normal part of commerce, and that it must remain covered up in order to protect democratic systems is ironic. Perhaps those who favor totalitarian and planned economic systems have been pleased with the disclosure of the indiscretions of some of their opponents, but it should be clear that it is the free American democratic system that has required the disclosure, that we cannot tolerate such corruption, and that our open society is strengthened by constructive self-criticism. That these facts have not gone completely unnoticed is evident from a statement in an Italian newspaper that, "If there are abscesses in their society, the Americans are not afraid to puncture them . . . ."

Indeed, the strength of a political democracy and a free private enterprise system are both dependent on an

informed constituency and, in the long run, both are eroded if information with respect to improper payments made to influence government decisions are not disclosed.

In short, I hope that I have conveyed my conviction that our free economic and political systems are supported only by faith and confidence that corporate and political leaders are acting with honesty and integrity in accordance with acceptable moral and ethical standards and that decisions with respect to whether such standards are being met can be made only to the extent activities are fully and fairly disclosed.

One of the major objectives of our securities laws is to protect investors and the public interest by requiring disclosure of all material facts concerning the operations of public corporations. Disclosure is a very effective regulatory tool. In addition to its major purpose of providing material information to investors which enables them to make informed investment decisions, disclosure also provides a mechanism whereby the activities of business institutions, whether large, small, local, national or international in scope, can be made responsive to the legal and ethical standards of the localities in which they do business. Another beneficial aspect of disclosure is that, to a significant degree, it provides regulation through economic forces such as the decisions of investors and consumers rather than through government edicts or direct intervention.

Because of our responsibility to administer the securities laws, the Commission has been instrumental in requiring the disclosures by corporations of the use of corporate funds for illegal or improper purposes. Our approach has been to utilize our powers of investigation and injunctive actions as well as offering incentives for corporations to examine and correct their own problems with minimal government action. We have sought prophylactic relief, not punishment, since the sanctions under the securities laws are remedial. In the enforcement area, we have brought 11 civil injunctive actions and have been successful in obtaining what we believe to be satisfactory disclosure and responsive corporate action. Another injunctive case was approved by the Commission earlier this week, and no doubt there will be similar Commission actions in the future.

In past cases, we have alleged, among other things, that the failure to disclose the establishment of off-the-record funds, the creation of false corporate books and records, the use of corporate funds for unlawful purposes, and the use of consultant fees or commissions to bribe foreign government officials has resulted in violations of our federal securities laws.

The relief obtained in these cases includes court orders prohibiting the continuation of such activities and requiring the companies to appoint a committee of independent directors and attorneys to undertake an in-depth inquiry of their past and present corporate conduct. The court orders have also required that the findings of these inquiries be reported to the court, the Commission, and to shareholders. The possible effectiveness of such inquiries was recently illustrated when one such report caused a corporation's top management to be replaced.

It is also important to know that in obtaining this type of self-inquiry the SEC acts as an effective catalyst for corporate reform to a far greater extent than would be possible utilizing solely its own budgetary and manpower resources. According to the annual 10-K report filed with the Commission by one corporation, the investigation by its appointed committee to ascertain the facts with respect to its illegal and improper payments cost the company about $3 million. This was equal to nearly seven percent of the Commission's total budget of $44 1/2 million last year, a budget which is already strained to capacity to bring enforcement actions, to process registration statements, to conduct regulatory activities with respect to broker dealers, investment advisers, investment companies, utility companies, exchange and

over-the-counter securities markets, and to process reports received from the 12,000 corporations which are subject to our disclosure requirements.

In addition to our enforcement program, our so-called "voluntary disclosure program" has also been very effective. Although there can be no clear line of demarcation between the enforcement program and the voluntary program, because the Commission obviously cannot guarantee that an enforcement action will not be brought if it is warranted by information discovered through the voluntary program, participation in the voluntary program may reduce the necessity for an enforcement action and may also reduce the degree of required disclosure. In instances where the Commission has initiated enforcement action, we have been satisfied only with a full report of activities, including names, places and payments, regardless of the amounts involved. Under the voluntary program, we have not always required disclosure of the specific identities of the recipients or the names of the countries involved from participants. We have, however, suggested certain "generic disclosures" and requested that the companies agree to grant our Enforcement Division access to their investigatory files so that the information presented to us by the company can be verified.

A company participating in the voluntary disclosure program generally undertakes an internal inquiry of its

conduct over the past five years by a committee of independent directors with the assistance of independent accountants and outside counsel.

Upon completion of the inquiry, the committee will prepare a report setting forth its findings and submit the report to the full board of directors. The report should set forth detailed information about each payment; how it was made, the country in which it was made, the amount involved, the recipient, and the reason for the payment. Although reports of this type have been filed with the Commission as part of the settlement of enforcement actions, the Commission has not insisted that companies file such a report under the voluntary program. Nevertheless, a company's board of directors must deal with the information in the report and the response has generally been to adopt a policy statement regarding such payments or reiterate a previous statement and to consider what public disclosure, if any, should be made.

The policy statement usually indicates the board's disapproval of the practice of making illegal or improper payments, and sets forth a declaration that such payments will not be made in the future; that false entries will not be made in the company's books and records; that any employee who gains knowledge of any policy violations shall report such activity promptly to a designated company official; that

employees violating the policy will be appropriately disciplined, including possible termination; that the company's independent auditors will be instructed to watch for evidence of such payments in their annual audits; and that the policy statement will be distributed widely to all appropriate supervisory employees.

If the company's board of directors decides that some disclosure about the payments detailed in the report of the independent directors may be appropriate, it will normally authorize company officers and counsel to discuss the matter with the Commission's staff. The disclosures made following such discussions have included: a statement of the amount of payments made and their purpose or the nature of the corporate activity to which they relate; a statement of whether any member of the top management or the board of directors authorized or knew of such payments; a statement of whether the payments involved the maintenance of false books and records or the use of funds outside the corporate accountability system; a statement of the company's policy with respect to the making of such payments in the future, the use of funds outside the accountability system, and the maintenance of books and records containing false or misleading entries; a statement declaring cessation of all such activities, if one has been adopted; a statement of whether or not cessation of such payments is expected to have a material effect on the

company's business, and, if so, a description of that effect including the amount of business related to such payments; a statement of whether any tax impact will flow as a result of the improper deduction of such payments; and some companies have included a statement that the payments have been voluntarily reported to the Securities and Exchange Commission pursuant to its voluntary disclosure program.

I believe it is significant that some companies have chosen to make disclosures which were more extensive than those suggested by the Commission. Several large corporations have described with specificity payments which amounted to a few thousand dollars or less, and a number of companies have indicated that they were motivated to disclose questionable payments in order to avoid the embarrassment that could result from disclosing such payments for the first time in response to a request at a shareholders' meeting.

The most difficult question we face with respect to the improper use of corporate funds is when must such payments be publicly disclosed? The answer to this question is that they must be disclosed when a reasonable investor would be likely to consider such facts important in making an investment decision or in making a decision on how to vote in a proxy solicitation.

But that is just the starting point for analysis. Unfortunately, we do not have access to answers from the

"theoretical reasonable investor" as to what constitutes facts important in making such decisions. Most, if not all, investors believe themselves to be reasonable and yet consider different facts important in their decisionmaking. Let me share with you some of the difficult considerations which have been discussed at great length by the Commission.

Does it make any difference for purposes of disclosure who authorized the illegal or improper payment and who accepted it? Perhaps not from a moral or ethical viewpoint, but it could make a difference to investors whether the action was sanctioned by top management or whether such payments were made by a lesser employee in the company against company policy and without management's knowledge. Another significant factor might be whether the payment was made to a high government official, or with knowledge that it would be passed on to such an official, to influence the making of a decision other than on its merits. In my opinion, the greater the position of power or responsibility, the more important it is from a societal viewpoint to act with integrity, and the more important it is that improper activity be disclosed.

Can the importance of disclosure be determined on the basis of the size of an improper payment? Size may be an important factor, but the size of payments may be a very small percentage of a transaction and yet an extremely large absolute sum of money for an individual and, thus, a very strong improper influence.

Is the amount of business affected by the payment or the amount of business done by a company in the country in which such a payment is made a determinative factor? It could be in some instances, but it cannot be dispositive because knowledge of an improper payment in one country can and has resulted also in adverse reactions such as nationalization of property, nonpayment for previously expropriated property, cancellation of contracts for future purchases, and revocation of operating permits in other countries.

Should the size of a payment as a percentage of foreign sales, profits, or assets or total sales, profits or assets be a factor in determining whether to require disclosure? If it is, the result could be that a multi-billion dollar corporation with a small division equal in size to the total operations of a small competing company would not be required to make disclosures of the same dollar size improper payments as would be required of the smaller company. In my opinion, this would be inherently unfair and, thus, an unacceptable government policy.

Does the country in which an improper payment takes place make a difference in whether it should be disclosed? Although it has been suggested that such payments are a way of life in some countries, we have seen that they have been made in all parts of the world, in developing countries, and in the most highly industrialized countries including our own, and I am not aware of an official statement from any country

that bribes of their government officials are acceptable. Experience has shown that peoples in all countries are incensed by such payments, and perhaps Prime Minister Miki of Japan said it best when he stated, "We cannot overcome the present difficulties without having the people's trust. And to obtain this trust we have to reveal the truth."

Do all payments approved or known to management reflect on its integrity and its stewardship of the company and thus require disclosure or should small expediting payments be excluded? If a distinction is made, what is the dividing line between the significant payments and those which are not significant?

Should disclosure be required of all payments involving funds outside the accountability system or involving false books and records? The response to this question would seem to be obvious in the affirmative because without such disclosure the integrity of the company's accounts would be called into question and investors could not be assured that the financial position of the company is accurately reflected, yet the specificity of terminology that should be used to describe such payments and the extent to which they should be isolated from other expenditures are subject to disagreement.

Although the Commission has been criticized for not providing clear guidelines as to what it considers improper corporate payments, we have been unable to provide guidelines

because the facts in each case differ so significantly that meaningful categorization is difficult, if not impossible. In deciding when questionable payments must be publicly disclosed, the Commission has proceeded on a case-by-case basis, considering the recommendations of our staff and the written submissions of the companies involved, and in my opinion, we should continue to proceed in that manner. As we gain experience, however, we can expect certain patterns to emerge, and I believe that some patterns are already emerging.

Where public disclosure has already been made, and top management, including nominess for directorships were not aware of or did not authorize the improper payments, the Commission has generally not objected to non-disclosure in proxy statements. Along with other factors, when one or more members of top management authorized or were aware of relatively small improper payments, the Commission has required generic disclosure of the payments and the fact that management knew of or authorized them, but generally the name or names of those involved have not been required to be disclosed. In a borderline case, the fact that payments have ceased made the difference between disclosure and non-disclosure. If a company which has not yet completed its own investigation requests an advisory opinion from the Commission as to the materiality of certain information, we have generally felt

constrained to take no position or to inform the company to proceed on its own. In some instances where information was not, strictly speaking, required to be disclosed, we have had the staff inform the companies of that fact but have also had the staff inform the company that the Commission believed making those disclosures would be a good business practice.

Lest you have the impression that the Commission's concern for improper payment activities pertains only to the international markets, I should indicate that we are aware of and have brought enforcement actions against companies which have made similar types of payments in our domestic markets, either to influence government officials on national or local levels or to obtain benefits other than in the ordinary course of business. While we do not know how widespread these practices are in this country, reported estimates of domestic commercial bribery activities range from a two year old Chamber of Commerce figure of $3 billion annually to an estimate of as much as $15 billion by a lawyer who has considerable experience with fraud and other questionable corporate conduct. The corporate community should be aware that the Commission has a responsibility, which I believe we will fulfill, to investigate any such cases brought to our attention and take whatever enforcement action is appropriate, including the requirement of public disclosure.

To date approximately sixty-five companies have made public disclosure of improper foreign or domestic payments, either as a result of enforcement action or through the voluntary disclosure program, at least 15 companies are currently discussing disclosure problems with the staff, and I expect that the number will continue to grow in the next month or two as many companies submit their 10-K reports and preliminary proxy materials. Moreover, our program has prompted many companies to look more closely at their operations, and a growing number have simply filed disclosure information with us concerning improper payments without prior consultation with our staff.

While there are still many who suggest that bribes, kickbacks and other illegal or improper payments are normal and necessary in commercial transactions and that American companies will not be able to compete in international markets unless they are allowed to make such payments, the tide is turning and many business executives who disagree with such claims on the basis of their own experience have spoken out on the issue. Mr. David S. Lewis, chairman of the board of General Dynamics, which was successful in obtaining what has been called the "deal of the century" to sell F-16 aircraft to several countries in Europe and in the United States, is quoted in the New York Times as saying that:

> There were zero payoffs, there were zero bribes, there were zero offers. There's nothing in the future and there'e nothing in the past, and there'e no one in any of these governments that has to be awake nights wondering when the whistle is going to blow on him because it isn't going to happen.

Mr. A. W. Clausen, president of the Bank of America has stated:

> Integrity is not some impractical notion dreamed up by naive do-gooders. Our integrity is the foundation for, the very basis of our ability to do business. If the market economy ever goes under, our favorite villains--socialist economies and government regulators--won't be to blame. We will.

Mr. Frank T. Cary, chairman of IBM has said:

> When some businesses turn out shoddy products or engage in misleading advertising or ignore customer complaints, the public gets sour on business as a whole. When some executives have to admit that they bribed foreign officials or illegally channeled corporate funds into political campaigns, the public believes this is standard business conduct. And when we read in the papers about corporate kickbacks and secret Swiss bank accounts, all business suffers. Some businessmen have tried to excuse themselves by saying that everybody does it. Well, everybody doesn't do it . . . The time has come for those of us in business to put our house in order . . . to restore the faith of Americans in the basic competence and purpose of business. And this requires a lot more than public-relations efforts.

These statements are representative of many which are being made by businessmen who do not like to be improperly categorized with firms in the business community which apparently are, through their shortsighted, improper corporate activities, jeopardizing the private enterprise system that makes it possible for their businesses to exist. I am pleased to see businessmen who are not afraid to support and speak out in favor of moral and ethical conduct in the business community, and I would like to conclude by suggesting that the only way for the business community to avoid additional burdensome regulation and legislation is to accept the responsibility to establish and maintain high ethical and moral standards and to disclose fully and fairly their operations so that shareholders and the public will know that everybody isn't doing it.