THE COMMUNITY OF INTEREST BETWEEN THE GOVERNMENT REGULATOR AND CORPORATE MANAGEMENT.

Remarks of

Commissioner

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When I was invited to come and talk to this forum, well known as it is for the caliber of its audiences, I felt highly complimented, as did my fellow Commissioners of the Securities and Exchange Commission who have preceded me here.

In searching about for a subject to discuss with you this afternoon, I felt somewhat at a loss for a topic, because I had been told that you have diverse interests. I rejected the idea of talking about technical aspects of the Commission's work, for the reason that it seemed inappropriate for the Commission "freshman" to speak for the Commission on its many, and ofttimes controversial, problems. Then, too, quite apart from that, I thought that such a topic would have no particular appeal to all of you.

With your indulgence, therefore, I propose to speak briefly on my philosophy of the relationship between the SEC regulator and corporate management. I have the notion that between these two there is a community of interests. This notion is not newly-acquired, but is one that has grown on me over the course of the past 12 years. My contact with the securities business pre-dates by a considerable time my appointment as a Commissioner. From 1941, until my recent appointment, I served as the Regional Administrator of the Boston office of the Commission. If I have achieved any fundamental insight into the relations between us and business, it's that, in the areas where SEC regulation impacts on corporate management, our objectives are strikingly similar, and that we must both employ pretty much the same techniques to attain our respective ends.

Too often the unthinking person assumes that Government and industry are east and west in the Kipling sense. That is not my thinking--nor does it accord with the philosophy which I bring to my job as a securities

regulator. I suppose that such a view is characteristic of the formative period of regulation. At that stage it is natural enough to expect to find, on the one side, that those subject to the regulation are fearful of the unknown and the untried; and to find, on the other side, perhaps an excess of zeal on the part of the regulators, born of an enthusiasm to correct the evils which brought the regulation into being. During our formative period, our relations with industry, as one might expect, were somewhat strained. That period, however, was short-lived. I think we grew out of that period because of an appreciation of the mutuality of the objectives which management has on the one hand, and the SEC has on the other.

There are inevitable reasons for this community of interest. In the first place, as I see it, we both owe our existence--in a deep and real sense--to the same group of citizens. Corporate authority derives from the consent of stockholders to be governed by the management. This consent expresses itself in the corporate charter and by-laws, to which they have subscribed. The securities regulator derives his authority, in a larger sense, from the same source. The consent of the American investing public that the securities regulator should have a hand in maintaining the integrity of the market is expressed in the laws creating the Securities and Exchange Commission. Our common constituency is, by the way, a very sizable one. I have seen estimates of the numbers of security holders in this country, ranging all the way from about six to fifteen million. Experts say that there are no reliable figures available from which the number of people who own securities can be obtained with any close degree of accuracy. However, the figure is not important for our present purposes. It's enough that these people are a large and important segment

of our population, and play a vital part in our economy. It goes without saying that management, perhaps more so than government, has the best of reasons for protecting that group.

Our community of interest involves more--we have the same ultimate objective, which, in the final analysis, is the maintenance of a healthy and prosperous economy. There are certain methods to be used and procedures to be followed in the achievement of that end--and we share the same vital concern in maintaining the integrity and effectiveness of these methods and procedures, and in searching for ways and means for their improvement.

Facts and figures are essential to the effective functioning of the managerial process. To get these data accurately and reliably management must get down to grass roots. It can't tolerate inaccuracies and distortions, nor can it go blithely on its way looking only within itself, without regard to what its competitors are doing, or what is going on in industry in general. And to get these data it must rely upon the recognized techniques--the application of generally accepted accounting principles, the opinions of engineers, attorneys, and research experts of various kinds. So too, the securities regulator, if he is to perform his function properly, must have equally reliable information and must employ the same techniques to secure it. Both know that the quality of the data can only be as good as the means and methods used in digging it out. A balance sheet, for example, is only as good as the accounting methods used in its preparation, the findings and opinion of the expert, such as the engineer, the geologist, the analyst, are of value in direct ratio to his qualifications. And, so as I say, I, as a securities regulator, must interest myself in the quality of these fact-finding processes, and be as quick as management in rejecting unorthodox or unaccepted procedures, and in refusing to accept conclusions of various kinds of "experts" who do not in fact qualify as such.

I want to dwell briefly on the matter of financial information, to bring out this point of our common interest in the technique used in obtaining the necessary figures. It is not enough, important as it is, that financial data be presented as accurately as its nature permits. In addition, there must be the maximum of consistency in its determination and presentation. The corporate manager must be able to interpret not only the financial statements of his own company, but also those of other businesses. He must have that ability if he is to make intelligent comparisons, and thus determine how his company is progressing in relation to competitors, and to enterprises in other industries. If a given account on his income statement means one thing, and the same account on the competitor's statement means something else, a valuable source of necessary information is closed to him. And so it is of concern to him that the methods employed in account keeping be based upon objective standards, which have been tested and are recognized universally in the business world to be sound procedure for the recording of financial facts. An adherence to this principle advances the interest of securing a minimum of variation in financial reporting, not only among businesses in the same industry, but also among different industries. So too, the regulator looks for that same quality in order that financial statements shall serve their purpose of presenting an adequate financial picture of the enterprise. As I remarked, absolute uniformity cannot be attained, but much progress has been made in narrowing the areas of inconsistency which have existed. More has to be done, and the mutual interests of those who regulate, and those who manage are of necessity important forces in accomplishing progress.

Management has a vital interest in encouraging the flow of capital to the business for which it is responsible; and to do that it must compete with other companies and with other industries. Self-interest impels it to disseminate information calculated to arouse interest in the enterprise, to reveal its past successes and its reasons for asserting that those successes will continue. In short, as I see it, the publishing of information is the most effective means available to management to bring to the investing public the success story of American business. A good investment can stand being honestly described. A bad one needs to be honestly described. One of the inevitable results that flows from honest description is the discouragement of enterprises which are undesirable from the economic point of view, before too much harm is done. The securities regulator concerns himself with seeing to it that the American investor gets the information which he needs to decide intelligently where and how he shall invest capital. Of course, it is no concern to the regulator what form these investments take, whether it be insurance, bank deposits, corporate securities, or the many other media of investment. That means, in a sense, that his job is to protect honest enterprise, seeking capital by honest presentation, against the competition afforded by dishonest securities offered to the public through crooked promotion. If he does that job well, he helps to preserve the confidence of investors, which is the first requisite for a sound financial system.

The problems of corporate management are too many, and too complex, to demand of it the performance of unnecessary and useless tasks. Industry chafes at government regulations which require it to furnish a mass of unnecessary data to the public. As a securities regulator I sympathize with that attitude. Useless information serves only to confuse the investor, and thus tends to thwart the very purpose of our legislation. Having

an appreciation of this, the Commission has worked assiduously with management to cut down the amount of data required to be furnished, to the end that the investor will get a package of information that can be used easily and intelligently. Our forms have been simplified, and many that were once used have been abolished, or consolidated with others, in order to eliminate duplication and unnecessary data. As a result of these efforts, prospectuses are much less voluminous than before, and, by the same token, are of greater value to those who use them.

The Commission has been working to cut down, as well, the burdens of compliance. In many situations, as some of you know, securities distributors are required in effect to make a double distribution of prospectuses; first, the so-called "red-herring", and second, the definitive prospectus. There are good legal and practical reasons for this in many cases. But we have made, at least, a beginning in easing the burden of double distribution in our very recent adoption of a rule applying to situations where rights or warrants to subscribe to additional securities are offered by the issuer to its stockholders, there being no underwriter involved. The rule provides, in substance, that in such offerings the prospectus requirements of Section 10 of the Securities Act of 1933 are met if the issuer gives to its stockholders a proposed prospectus meeting the requirements of our Rule 131--that is, the so-called "red-herring" prospectus--and, within twenty days thereafter, sends or gives to the same stockholder a document which incorporates the proposed prospectus by reference, and which contains the price and price related data omitted from the "red-herring". Before the adoption of this new rule, which we call the "document" rule, it was necessary for the issuer, after the effective date of the registration statement, to send to its stockholders, with the warrants or rights, a complete prospectus which set forth the price and price data, as well as the

information contained in the "red-herring". It became apparent to us that this requirement involved a tremendous amount of time and expense; and that it did not have the compensating value of substantial benefit to the people to whom the offering was made. Apart from the elimination of expense, we believe that the effect of the rule will be to stimulate the dissemination of information concerning the proposed offering, prior to the effective date, and thus give to the stockholder the essential data, and time, to enable him to form an intelligent judgment. I submit that we have made considerable progress in this way, but I know that much more can be done.

I referred to the desirability of diverting capital from the enterprise which has no proper place in our economic scheme of things. Perhaps this deserves further mention. The capital resources of our country are not infinite. I am not being a prophet of doom when I say that. For that matter, maybe you will say that I am a purveyor of platitudes. However, I think that the common interest in eliminating waste of capital is one of the very strong bonds between the business man and the Securities Commissioner. It is interesting to speculate upon what sound business could have done with the billions that have been literally wasted. But it is futile to bemoan spilled capital. Here again, as I see it, our most effective weapon is publicity, to be used before the harm occurs. True, there is the police power, but that usually comes into play after the damage has been done. The taking of steps at that time does not help economically. American industry is in a stage of expansion. Thus, the need becomes more and more pressing to plug up the rat holes into which the money of investors may be tempted by parasites posing as entrepreneurs. It's naive to think that waste of capital can be entirely prevented, but certainly a lot can be done toward that end. How much is accomplished depends

upon the recognition by the business man, and the government regulator, that their interests in this work of conservation are inextricably bound together.

The maintenance of free and orderly markets for securities, which fairly reflect their true values, is another one of the interests which the regulator and the manager share. By enhancing the marketability of stocks and bonds, and thus aiding the free flow of capital, these markets are necessarily of high value in the process of tapping our financial resources. To the extent that they are tampered with, manipulated, rigged, or whatever term you wish to use, their value to industry is lessened. The only ones who can benefit are the few who pull the wires to make the market dance. The resulting loss to the pocketbook of the investor, and to his confidence in the securities markets, is an evil which is visited upon management when it seeks capital for legitimate purposes. Management knows that, and does not look with complacency upon the exploitation of these facilities which are so important to it. So too, the securities regulator, in pursuing the common objective, is concerned with the preservation of these markets and for the same reasons.

Responsible and enlightened management concerns itself with the development of interest in the enterprise by its stockholders, and to that end is interested in telling them about the progress and problems of the business. After all, the tradition of annual reports to stockholders predates the SEC by many years. Since early in our history many companies have made it a practice to tell their stockholders periodically about developments in the business. Semi-annual and quarterly reports on a voluntary basis are not infrequent today. Quite independent of regulation, disclosure, as an inherent element of sound and fair management, has become an American tradition.

Enlightened management shares with the Commission the wish to further the opportunities of stockholders to express their views to management. To enforce and facilitate that process we have promulgated our proxy rules. You might say that the corporate proxy is a means of arranging a meeting place between management and stockholders--a meeting place on paper, if you like. The proxy rules have, as their simple purpose, the aim of bringing about a fair and representative meeting. The stockholders' meeting was, in our earlier days, traditionally an occasion for a general probing of management and airing of views. I have never been able to understand the critics of our proxy rules, who say that the opportunity these rules afford for stockholders' presentation of views is a radical measure. To me, they seem no more than a continuation of a tradition established long before the SEC was ever thought of.

The integrity of its business judgment is something which the management holds dear to itself, and it is quick, and I think rightly so, to resent any attempt to encroach upon that function. I believe it entirely foreign to my role in the scheme of things to presume to substitute my judgment of what is best for the enterprise, for that of men selected by the owners of the business to operate it on their behalf. What is more, and perhaps you can guess this by looking at me, I come from a race that is known, among other things, for clamoring for the principle of Home Rule. I don't know why that ideal shouldn't apply to the government of business just as it does to the government of people.

I have spoken -- and not at too great length I trust -- of my concept of securities regulation. A word, if I may, about how the Commission seeks to further the interests to which I have referred. The laws which we administer are pretty much what we make them. You will recall that our legislation was enacted because it had become painfully clear that the

interests of security holders were not being adequately protected against certain classical abuses. And so at the beginning we had the opportunity, and perhaps reason, for regarding the authority given to us as being essentially a police power over those who issued or dealt in securities. I think that the history of the Commission shows that it rejected that alternative, and committed itself to the view that its job could be done better by education and cooperation, rather than by the threat of sanctions. I believe that the Commission's victories and progress are measured, not in terms of numbers of successful prosecutions, but in terms of the extent to which it has been able to make the spirit of its laws a working force in the everyday conduct of financial affairs. The successes that miss the headlines are often the most important ones. Our greatest single achievement, I would say, is that, in spite of differences and arguments about details, and the mechanics of doing particular things, there is no longer any disagreement with the basic policies of full disclosure, and fair and honest treatment of investors, which are embodied in our Federal securities laws.

The Securities and Exchange Commission is, by law, a bi-partisan Commission. As a member of the staff in close contact with the Commission for many years, and as a Commissioner, I have always been struck by the singular fact that the Commission has never, in its entire history, been split by party lines on any issue. It is best to describe the Commission as a truly non-political organization. It has been such throughout its history and I am confident that it will remain such in the future. My reasons for that confidence are simple: Each Commissioner brings to his job the best that he has in ability and in conscience. It takes a very short time for a Commissioner to discover that, without regard to party, the

purposes of the laws we administer have a universal appeal and a fundamental value to all honest men. One cannot be a Commissioner long and not be imbued with its tradition of decent and reasonable application of the law. That tradition I intend firmly to adhere to.