

THE DISCLOSURE PHILOSOPHY

An Address By
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In planning my remarks for today, I was struck once more with the depressing thought: that I was not certain that I had anything new to say — a common affliction, no doubt, among persons who have rather frequent occasions to speak publicly. And, of course, prospective lack of novelty was depressing, because we all assume that only what is novel is newsworthy, and only what is newsworthy is interesting.

Last week, President Ford came to New York City, to address the New York Society of Financial Analysts, and then to attend a large dinner for Vice President Rockefeller. The press was intrigued with the visit to the Analysts Society, and reported in detail the comments of many in the audience, which seemed to have a common theme — the President came across very well as a man, but he really had nothing new to say. So I thought to myself, what a pity. Surely the President and his staff could have thought up something new.

Then I recalled a piece in the Wall Street Journal last November, by Herbert Stein, then recently resigned as Chairman of the President's Council of Economic Advisers. His theme was that Franklin D. Roosevelt has become the model for Presidents of both parties as embodying leadership through constant action, or activism, as Professor Stein prefers to put it. He wrote:

“The basic idea that FDR stands for to Presidents and to the public today is 'leadership.'... They cannot remember that after eight years of his leadership the economy was in worse condition than at any time since — including now — and the prospects were so bleak as to give rise to a whole school of secular stagnationists. What leadership means, as practiced by Roosevelt and considered a model today, is giving the people the feeling that they are going somewhere and that somebody knows where...

“Roosevelt's ability to come up with an endless series of programs and proposals was enlarged by his lack of commitment to any philosophy or principles of economic policy. This gave him a great variety of actions to choose from. He could choose from the box of economic planning or from the box of measures to promote a competitive economy... On one occasion, he even, briefly, made an action out of inaction, by declaring in 1936 that he would give business a ‘breathing

spell' during which he would propose nothing new. Such broad-mindedness in the choice of actions is sometimes called pragmatism, and sometimes called not having the foggiest notion of what to do.”

But, of course, Dr. Stein's interest, and mine, is not really FDR, but the demand for activism, at which FOR may have been the classical master, but which is increasingly with us today. To indulge in one more extended quote from this delightful essay:

“The irrational passion for action is not entirely due to FDR. Among other factors, our present total immersion in the media, notably television, contributes. The media offer the public such a quantity and variety of competing entertainments, some labeled 'news', that the politician can get the attention he wants and needs only if he is continually in motion. And the flow of words is so great that a mere presidential speech no longer gets noticed. Whereas Presidents used to make speeches to justify their actions, Presidents now have to think up actions to justify their speeches and make them 'newsworthy'.”

All of which led me to think again about the President at the Analysts a week ago. He was, during that period, intensively engaged in trying to arouse the citizens to support his economic program, especially that related to energy, against the opposition of many in Congress. He had talked in the

preceding days in Texas, Missouri and elsewhere, and each speech had been fully reported.

But what was he supposed to say on the subject — the subject he came to New York to talk about — that was new? How many new ideas on energy policy do we expect, or, indeed, want, the President to have in a week, or a month, or even a year? As an entertainer, television and the other media, but especially television, did to him what they have done to so many. He blew all his material in his first performance. But as a President, he still has the same message.

Now, I am not really so presumptuous as to compare the Chairman of the SEC with the President. But I and my colleagues do get pretty thoroughly covered by that particular segment of the press devoted to the securities markets and our efforts to regulate them — the markets, not the press. One of my predecessors established the unfortunate practice of distributing written copies of speeches, and these get reported on and frequently reprinted. As I see them pass by, they have a sorry lack of variety. So some of the temptations Dr. Stein describes are present. Headlines are fun, and dropping a brick or a bomb in a speech is a sure way to get them, at least if you can somehow keep the news from leaking out all over the landscape in advance.

While we have some of the temptations that must face the President, we don't have his elective position or his constituency. This, I can assure you, is a very good thing. It seems to be our fate to generate a degree of unpopularity

among those that know us best. I suppose it is somewhere in the fine print of our job descriptions. If we had to stand for election among the members of the securities industry right now, I would apparently return to private life somewhat sooner than I have had in mind. In this respect, we compare unfavorably, but also in a way favorably, with the President.

One of the services that devotes constant attention to us is a weekly publication called The Wall Street Letter, and they can get pretty cheeky. Last week, for instance, they reported the results of a poll taken from the heads of 174 member firms of the New York Stock Exchange.

The question was, on the whole do you approve or disapprove of the manner in which the following persons executed their responsibilities, these persons being — President Ford, James J. Needham of the New York Stock Exchange, Paul Kolton of the American Stock Exchange, Ed O'Brien of the Securities Industry Association, Gordon Macklin of the National Association of Securities Dealers, and your humble servant.

And I was much more your humble servant after reading the results than I was theretofore, because I came up last, with only 14 percent in the “approve” column. If I had to lose, I am happy that President Ford won, with 60 percent. On the other hand, I had a refreshing loss in the “No Opinion” column at only 2 percent. The people we regulate may not approve of the effects of my sojourn through the field of securities regulation, but I suppose I can take some comfort from the fact that at least they all remember I passed

through. You will be pleased to know that my brothers on the Commission acknowledge their full share in this glory

It has even been suggested, by some true admirers that one way to cure my dismal showing would be to announce that, due to my low standing, I intend to stay on for however long it takes to get my ratings up. One way or another, the industry should come around with that approach.

The only truly disheartening thing about all of this is that the people we are supposed to be helping, and who we think we are helping, keep sending me missives — some obscene, some otherwise — which serve as a constant reminder that, no matter who the subjects are, we might not fare too well in any poll.

I presume that the apparent difference in views between the Commission and the securities industry is largely, if not solely, the product of our action with respect to fixed commission rates — our action being to unfix them. But I don't want to talk about that business this noon. Everyone knows that from time immemorial the writ of the New York Stock Exchange has not reached north of Chambers Street, so I am in safe territory, and I would rather talk about another popularity contest we seem to be losing, namely, with bank regulators — or at least one bank regulator.

In a recent address to the American Banker's Association's National Trust Conference, Deputy Comptroller of the Currency Dean Miller let it be

known that he views the SEC — and the full disclosure provisions of the federal securities laws we administer — as a major force in the destruction of the American system of free enterprise.

My comrades on the Commission and I — while admitting that we have designated May Day as the date on which commission rates should come unfixed — wholeheartedly disagree with Mr. Miller's analysis of our efforts and the purpose and effect of the full disclosure philosophy underlying the federal securities laws.

There is no doubt that a major underlying premise of the federal securities laws is that full and prompt disclosure will best serve the purposes of both investors and corporate issuers. Notwithstanding some recent questioning of this philosophy, we are persuaded that the original assumptions — that full disclosure permits investors to make informed and intelligent choices; discourages hanky-panky on the part of corporate management; and operates to reduce suspicion and generate confidence — are as valid today as they were forty years ago.

The system did not impede, and hopefully facilitated, the unprecedented raising of capital by American industry during the twenty-five years following World War II. It may well be, in fact I think it is, the case, that it was the disclosure and market regulatory apparatus established by the Commission that encouraged, not to say lured, so many individuals during those years to return to the stock markets, and in such a big way. Sometimes

this rests heavily on our conscience, because the system did not prevent the disappearance of equally unprecedented sums in market values in the past five years.

To some modern economists, our laws and rules and activities had nothing to do with any of this, except to make it all more expensive for the benefit of lawyers, accountants, financial printers and bureaucrats. Not only, in their view, is fundamental information about companies irrelevant to the market place, but we haven't even done a very good job of enforcing disclosure and fairness — witness the examples of massive management malfeasance in recent years that have come to our notice and public notice only too late.

I find these observations a bit depressing. While we may be approaching a period when a government job will, in itself be something to treasure — unless Congress acts effectively to adopt a comprehensive and effective economic program, such as the one outlined by President Ford — none of us presently at the Commission is so hungry as to view with equanimity the awful possibility that it is all a monstrous charade.

Even more depressing is the criticism from the shorn lambs for whom we have been quite unable to temper the cold wind of lost savings and shattered expectations of economic security, if not great wealth. Some of them let me have it in rather strong terms. If they accept the fact that we never promised them a profit or even preservation of principal — a message

that does seem to have gotten around pretty well — then they accuse us of being pussycats when it comes to seeking out and imposing righteous retribution on those malefactors who are responsible for it all.

As to the first criticism — that fundamental information about companies is irrelevant to the marketplace — I simply cannot agree. Despite all of the computer models and random walks, I cannot accept the irrelevancy of fundamental analysis. But even if these critics should be correct to some degree, and fundamental analysis is not so important as we have traditionally regarded it, disclosure and fairness perform an important function beyond the purveying of data to analysts.

At this time of deep concern and even suspicion in so many quarters regarding the management of American business, it seems more important than ever that investors be confident that they are getting the real facts about publicly-held companies. It seems to me unthinkable that we should abolish or even curtail our system for the flow of corporate information regardless of how well an investor might do with a dart board. The realities lie in the other direction.

But how about the little fellow that got wiped out, or investors in the aggregate, who have lost well over \$500 billion in market value since 1972? Has the system been adequate for them? Obviously, it depends upon what was expected of the system. Here, I think the record is adequate, if not more. There seems to be sufficient realization that investors knew what they were

buying and that the government never promised anyone a rose garden, so that we have had no riots and little screaming for tighter controls or government ownership. The strongest felt pressure, from where I sit, is for more effective enforcement of the laws we now have.

Others have challenged our disclosure policy on the ground that its focus is too limited. Pursuant to a court order in the recent Natural Resources Defense Council case, the Commission will be particularly reviewing its present regulations regarding environmental and equal employment opportunity disclosures. The lawsuit brought against the Commission by the Natural Resources Defense Council sought the adoption of rules requiring more disclosure of facts relating to environmental and equal employment opportunity matters. Without presuming to tell us what, if any, rules to adopt, the court has ordered us to give more attention to these issues, which we will do.

The criticism leveled at us by the Deputy Comptroller of the Currency is even more fundamental. It has its genesis I believe, in the difference between the enforcement of our national banking laws and the federal securities laws. But Mr Miller's attack is aimed at the whole process of timely disclosure, at least of bad news, not just our enforcement action. He believes that the dissemination of bad news tends to destroy some shaky businesses that might otherwise be saved if the SEC would only adopt "a covert system of supervision" of public corporations similar to the system of bank regulation.

Given the recent occasions of involvement by the SEC in some frightening bank problems, and the sharp criticism levelled at the Comptroller's Office by some members of the Congress and others, I suppose that only my naivete precluded me from realizing that an attack like this was long overdue. But, whatever its genesis, we cannot cavalierly dismiss any complaints from reasonable and responsible men about the way that our system is working. The extreme depression of market values, a tide now hopefully stemmed or turned, and the severe shocks generated by recent massive securities frauds, do not warrant complacency. And I hope we have not exhibited any.

Mr. Miller is, in some respects, correct. We do have a bias in favor of early disclosure of trouble, a bias largely dictated by statute, but also by sound common sense considerations, too. While we worry about American businesses and the free enterprise system, we also know that without the confidence of investors — individual and institutional — that our system is fair, honest and efficient, and that malefactors who abuse the public's trust (not to mention money) will be held accountable for their transgressions, our free enterprise system will indeed be in danger.

My quarrel with Mr. Miller is not that he dared to criticize our enforcement and disclosure program — others less well-intentioned have done far worse. Rather, I feel some important concepts have been lost or confused.

We do not take comfort from the fact that we have uncovered some serious, damaging and undisclosed information about a company whose shares are publicly traded. Unfortunately very often the problems that come to light initially do not indicate how bad the problems really are. A good case in point was the Franklin National case.

When the holding company passed its dividend and disclosed the loss sustained by the bank's foreign currency operations we halted trading in the holding company's securities, even though it was announced that the holding company would raise new capital with \$50 million promised by Mr. Sidona, then associated with the bank.

Those promises were short-lived. If investors traded, or held on to, their securities in anticipation of the infusion of new capital by Mr. Sidona, they would have been sorely disappointed. Mr. Miller claims that the rehabilitation of the Franklin National Bank became impossible once the SEC got involved. But he failed to note that, at every step along the way, we attempted to cooperate with bank regulators and kept them advised in advance of our actions and that the bank regulators only belatedly realized that rehabilitation of the Franklin Bank had been impossible for a long time.

Should we have allowed new investors to get hurt? That is the concept I think Mr. Miller, and others, have overlooked. We know that publicity doesn't always help the company involved, or its existing shareholders. But it

does prevent future investors from dealing in a rigged market — a market where the sharpies are trying to bail out before the supply of suckers runs out! This approach isn't endemic to the SEC or the federal securities laws. Every Ponzi scheme — from the most innocuous chain letter to the most sophisticated fraud — depends on new victims, and must be stopped as soon as the fraud is uncovered.

While I prefer not to use the word “covert,” to describe what I think is Mr. Miller's concept of reasonable pragmatism in the enforcement of the federal securities laws, we often “correct,” in a quiet and satisfactory manner, simple technical, or temporary, infractions of our governing laws. Far too often, however, crisis situations, which are really what Mr. Miller is concerned about, are neither innocent nor temporary and the trouble is far worse than first appeared.

We cannot overlook the fact that, once such bad news arises, some investors may be hurt, but they are going to be hurt eventually anyway unless they get out by selling to some unsuspecting investor. And, if, as is so often the case, fraud or worse is involved, a lawsuit must be brought, new management brought in, and investors — existing and future — informed.

I do not want to appear to be indifferent to the problems that may be presented by required disclosure of corporate difficulties. As with any moral absolute, disclosure can present dilemmas. Mr. Miller's experience in bank regulation no doubt has presented the dilemmas in peculiarly sharp form.

More obviously than industrial companies, banks can exist only on collective faith. No bank can be liquid when faced with a stampede of depositors wanting to withdraw. Even if the old-fashioned run on a bank has been eliminated by deposit insurance, lack of confidence can and does produce a sort of creeping run — time deposits are not made, balances are gradually reduced, and so on.

We are aware of the significance of this fragile, largely emotional state. Unhappily, we are also aware of large sums lost by time depositors above the insured limit who made their deposits while the bank was suffering from undisclosed difficulties and vain and hopeless rehabilitation efforts were in progress. When the collapse finally occurs, it does not add much to confidence in banks for people to realize that it was permitted to accept large deposits while already suffering from fatal illness. Nor are persons who bought the stock of the bank or its holding company during this period favorably impressed.

This sort of problem is more obvious and dramatic with banks, but it is not limited to them. An industrial company with a hopefully temporary cash flow problem may suffer instant insolvency if it is denied all credit. A company known to be in bad straits may lose customers who prefer a supplier who will be around next year. Good executive employees may go away or not come. And so on. There is no denying that disclosure of company trouble may make the trouble worse, even fatal.

But how much cover-up does this justify? One problem is that undisclosed trouble does not often remain secret very long. Selective leaks occur, whether or not intended. The smart money gets out at the expense of the dumb money, meaning the ordinary investor. When the collapse finally occurs, if it does, the public once again has the realization that it has been had. We are not opposed to salvage operations where there is reasonable hope. We do not favor bankruptcy as the solution to every corporate difficulty. But still less do we favor a system that seems to tell the ordinary investor that he will always be the last to know and the first to lose. Such a message does not seem to be the way to attract individual savings back into the equity markets.

If this seems to be a more moral than pragmatic posture, the same may be said of the fundamental problems which our society faces. We have practical problems that require practical solutions, but these are simple compared to the deepest angst from which we have been suffering and still suffer.

We must restore confidence, not just in the technical competence but in the moral adequacy of our leadership, economic as well as political. This is the essential foundation on which practical improvements must be based. We cannot do this by telling the ordinary investor that all of our fancy Federal regulatory apparatus ends up, for him, as the same old rat race; that when trouble comes to a company, the government will secretly conspire with management to protect the investor from the facts and try to save, not just the

company, but management, too; but, of course, if it doesn't work out, those in the know will have saved themselves, and the final burden will once more fall on the little guy.

I think we all share a deep concern for establishing confidence in American business management, not just to make money, important as that is, but to achieve socially desirable goals. And I don't need to remind you of the widespread disenchantment with, and even hostility toward, our present system of economic organization. The total process of rehabilitation involves much more than the federal securities laws, but it surely includes them. Corporate disclosure is an important part of the process, the importance of which is by no means limited to enabling individual investors to make simple buy or sell decisions. We are concerned with preserving our present economic structure as against the disastrous alternatives.