Final Report
of the
SEC Major Issues Conference

January 13-15, 1977
Washington, D.C.

United States Securities and Exchange Commission

Roderick M. Hills, Chairman
Philip A. Loomis, Jr., Commissioner
Irving M. Pollack, Commissioner
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PREFACE

The report that follows is the product of the deliberations of 64 conferees from 11 states and the District of Columbia -- including former Chairmen and Commissioners of the Securities and Exchange Commission, industrialists, representatives of public interest organizations, investment and commercial bankers, law professors, other representatives of the academic community, members of the practicing bar, accounting professionals, and government officials. They met in the first Securities and Exchange Commission Major Issues Conference in Washington, D.C, January 13-15, 1977. The Conference was held at the request of the Commission to consider four major policy issues which affect, or will

be affected by, many of the important individual decisions to be made by the Commission over the next year.

Broadly stated, the agenda topics included the process by which new Commission policies and standards are developed, the effects and implications of organized trading of standardized options, the Commission's role with respect to the internationalization of securities markets, and the establishment of accounting and auditing standards.

The Conference format was patterned after that developed by Columbia University's American Assembly; background for the deliberations consisted of discussion papers prepared by the staff of the Commission. The participants were divided into three working groups, each of which, although meeting separately, deliberated upon the same four agenda topics during working sessions held on Friday, January 14th. Each group had a discussion leader and a rapporteur who provided direction for the discussions and, at their conclusion, reduced the views expressed by the conferees to a draft report.

The participants met in a plenary session held on Saturday, January 15, 1977, reviewed the draft report and concurred in the statement which follows. The statement represents a general agreement; however, no one was asked to sign it. Furthermore, it should not be assumed that every participant subscribes to every conclusion or recommendation expressed.

The Securities and Exchange Commission, as a matter of policy, takes no stand on the matters presented in the discussion papers, the public deliberations, or the opinions, findings and recommendations of the participants acting in their private capacities. The views expressed herein do not necessarily reflect the Commission's views on these matters.

I. ESTABLISHMENT AND ARTICULATION OF POLICY BY THE SECURITIES AND EXCHANGE COMMISSION

In recognition of the varied methods by which the Commission can and does articulate policy, the participants considered whether Commission policy is developed and communicated effectively; the persons and entities that should influence the development of Commission policy; and how the Commission could improve its policymaking functions.

Policymaking Within the Commission

A key prerequisite before the Commission can determine policy in the most efficient and effective manner is a more formalized recognition and re-evaluation by it of its mandate, mission and constituency. This needs to be done in light of the changing environment in which the Commission makes policy. While the Commission has been successful in making and articulating policy by diverse methods, concern was expressed that it has not always made clear the purposes for which its policies were formulated. The mandate of

the Commission is not directly to influence the economic policy of the United States. The Commission must carefully consider, however, the influences its regulatory or enforcement actions exert on the economy.

Planning is required by the Commission in order to accomplish its goals and effectively to evaluate the effects of its activities. Concern was expressed by some participants that the Commission is not aware, in all instances, that its actions, or those of its staff, involved the creation of policies, even when not so expressed. It was suggested that the Commission too often reacts to problems rather than anticipating them. Moreover, the Commission relies too heavily on an ad-hoc approach for the effectuation of policy. In a number of areas where needed, the Commission has not articulated policy in advance of the application of those policies. Even where an ad hoc approach may be required, it often results in staff members making policy, through the accumulation of unreviewed staff positions, such as in the case of some important briefs and no-action letters. Conversely, where the Commission has engaged in rulemaking or policymaking, it has sometimes done so in confusing and unnecessarily legalistic detail.

It was the group's consensus that staff no-action letters are too voluminous, making it difficult for affected persons, the bar, and others to keep current. In addition, these letters are often confusing because they usually do not set forth the reasoning by which the conclusions they contain were reached. To remedy these problems, the Commission is urged to review staff no-action letters periodically, perhaps quarterly, and to issue summaries of those letters it believes are significant. In addition, it was the group's view that the staff should be instructed to include a meaningful expression of the reasons why a particular no-action position was reached in these letters. The Commission also was urged to make clear that the failure of a lawyer to have read a no-action letter does not constitute either professional misconduct or negligence.

The Commission should more often articulate and spell out the rationale for its policies in advance of their application. Policy is better understood, and more likely to be well-received, if it does not come as surprise to those who must comply. A high degree of skepticism was expressed with respect to the Commission staff's perception that prospective guidelines are a roadmap to fraud, necessitating reliance on enforcement activities to develop and enunciate Commission policy. Many participants believe that guidelines can be amended if experience shows them to be inadequate or if new opportunities for fraud should emerge. If, as a result of the greater use of prospective policy guidelines, it might not be possible to pursue some enforcement activities, that is a small price to pay for the guidance and certainty offered by prospective guidelines.

The means by which the Commission can develop and communicate its policies vary, and the Commission should be cautious in its choices. Rulemaking and prospective guidelines, reports and policy statements are viewed by many of the participants as the preferred methodology by which to develop policy; the Commission should be reluctant to move away from rulemaking and its notice-and-comment process.

Conversely, speechmaking is seen by many participants as possessing inherent dangers not present in other forms of policy articulation. And, it was felt by these participants that a speech by an individual Commissioner or the Chairman reflecting anything beyond an explanation of existing policy, or an explanation of a policy just adopted, should carefully disclaim any reflection of the Commission's position.

While the choice between rulemaking and ad hoc Commission or staff actions is, concededly, often a difficult one, it was the consensus that rulemaking or policy statements (preceded by opportunities for comment, if possible), and not enforcement action, should be employed to change, modify or abolish existing practices engaged in on an industry-wide basis.

The Planning Function

It was felt by many of the participants that planning must be integrated into the operational functions of the Commission at all levels. While a formal, separate planning unit may not be necessary to effect planning at the Commission, the participants felt that such a unit could be useful to apprise the Commission of regulatory problems likely to result from business, technological and economic trends, and of the economic effects of what the Commission itself is doing, and has done. The presence of a Chief Economist, and economists in some of the divisions to assist the policy development at all levels was considered helpful.

A majority of the participants felt that, at the incipient stages of its reaction to a significant problem, either in the interpretive arena or in the enforcement realm, the Commission's staff should not proceed on its own, but rather, there should exist some internal system to insure that the problem can promptly be brought to the Commission's attention so that the staff may have the benefit of the Commission's views before proceeding. In such a situation, it was felt that the views expressed preferably should be Commission views and not staff views. Where the Commission finds itself reacting to a significant question on a case-by-case basis, many participants believe the Commission should attempt, at the earliest practical time, to summarize the major policies it has been, and will be, following. And planning, to be fully effective, must come at the Commission level as well as at the staff level.

Planning, however, requires more than the internalized methodology discussed above. Many participants believe that the Commission should expand both Its formal and informal communications with the various constituencies it serves, and should seek to increase the input it receives from other governmental agencies. The Commission should also supplement its internal planning function with external advice received, on a periodic basis, from ad hoc advisory committees. Conferences such as this Major Issues Conference, are also an effective device to assist the Commission in its planning functions and in the articulation of policy.

Policy Pronouncements

When the Commission proposes a rule for public comment, it should be required to act on that rule within a reasonable time period -- either through implementation or withdrawal -- and reasons should be given for the withdrawal of rules. The Commission should caution against the informal implementation of proposed rules that have not yet been adopted. In proposing rules, the Commission should state why it believes the rules it is proposing should be adopted, and should focus public comment on the general policy underlying the rule proposal, as well as the specific language of the rule.

II. ORGANIZED TRADING OF STANDARDIZED OPTIONS

The full-scale implementation of organized trading of standardized options has raised a new range of regulatory issues and concerns for the Commission. Accordingly, the participants considered whether the economic merit of options is a relevant factor to be considered by the Commission in its decision-making process; whether so-called pilot programs are appropriate for considering options trading programs; the potential for market manipulation resulting from the standardized options trading programs; whether certain market professionals should be barred from trading on inside market information concerning blocks of stock without prior disclosure; the effect of standardized options markets on the markets for the underlying securities or new companies on which options are not traded; and the effect of standardized options trading on the development of a national market system.

The Commission should not make decisions with respect to options on the grounds of a judgment as to their fundamental economic merit as investments. However, the speculative nature of options and the possibility of trading abuses warrant special vigilance by the Commission, as well as special rules with respect to suitability, disclosure and market practices.

While there are strongly-held individual opinions that options are siphoning off venture capital investment funds, the participants knew of no empirical evidence that establishes this. It is highly desirable to evaluate the economic impact of options on the allocation of capital and on individual investors. Economic surveys and studies in this area should be undertaken, either by the government or in the private sector.

While it is recognized that pilot programs such as that for options have inherent limitations and may, after a period of time, have the effect of foreclosing a later decision to proscribe completely, pilot programs do enable the Commission to identify any special needs for regulation. The participants believe that the Commission has proceeded appropriately in its option pilot programs.

Dual market making in options and the underlying stocks would present issues as to the potential for manipulation and for the misuse of market information. It appeared to the participants that there is less need for concern where there are competitive market makers in widely-traded stocks than where there is a unitary specialist or a thinly-traded stock. There should be caution in permitting unitary specialists to make dual markets.

The growth of options trading has focused attention on the issue of regulation of market information. In general, it is felt that greater competition and immediate disclosure are the best ways to resolve market information questions. It was the perception of the participants that options have become a significant factor in facilitating block trading and, to that extent, have enhanced the liquidity of the markets. Although there is concern with the "front running" of blocks, the Commission should be aware that unnecessary restrictions on the use of market information could have an adverse effect on market liquidity.

Concern was expressed by some participants that, through the facilitation of block trading and underwriting, options may have accentuated the so-called tiering of the market. However, the consensus was that it is beyond the scope of the Commission's mandate for the Commission to take action for the purpose of changing investor preferences for particular securities.

It is recognized that options may be a significant factor in the creation of the national market system and that there may be interrelationships between option experiences, the expansion of option trading and development of the national market system. In general, the options phenomena can be instructive for the development of a national market system.

III. INTERNATIONALIZATION OF THE SECURITIES MARKETS

Traditionally, the Commission has been largely concerned with domestic securities transactions, its primary goal being the protection of domestic investors in securities. The Commission has no special statutory mandate to encourage "internationalization" of the securities markets. It was the general view that the question whether or not this should be done was one of national policy to be decided, if at all, by entities other than the Commission.

On the other hand, given the international importance of the American capital markets, many questions have arisen as to the proper application of the federal securities laws to foreign issuers. The Commission, over the years, has made a series of practical compromises in applying its disclosure standards to such issuers, taking into account whether or not the particular issuer has or has not affirmatively sought to market its securities in the United States.

It was the group's opinion that the Commission had, in general, acted appropriately in developing such limited accommodations, without special bias for or against "internationalization," but on the basis of pragmatic considerations and the desire not unduly to contribute to the possible future dilution of the internationally-regarded quality of the American securities markets. Some of the participants believed that the Commission, could and should, grant additional accommodations to foreign issuers as to matters of disclosure which do not go to the essence of investor protection. Others where

more cautious on this point. There was general agreement that standards in the area of financial reporting should not be further reduced in the absence of compelling circumstances; and, in any event, careful reconciliation with United States standards should be required. In reviewing this area, the Commission could appropriately continue to emphasize the distinction between standards applied to issuers who seek to sell securities, or list them, in the United States, and issuers whose American security holders have been acquired solely through market trading.

It was deemed appropriate for the Commission to proceed with caution in any program to expand the required disclosures in the registration and reporting Forms 20 and 20-K, designed for foreign issuers who affirmatively seek access to the American markets, although, as a general proposition, the effort to bring the requirements for such foreign issuers and for domestic issuers closer together was viewed as a desirable one. It was noted that more than three-fourths of the 500 largest non-United States corporations were domiciled in eight European countries and Japan. This being the case, it was urged that the Commission should undertake discussions with the appropriate bodies in such countries as a prelude to any revision of these two Forms.

The participants understand the Commission's historic concern with the possibility of resale without prior registration in the Unites States of securities initially offered abroad by American corporations. This concern has resulted in the perpetuation of cumbersome, ad hoc, "no action" procedures being required in all cases of foreign offerings by American corporations through American underwriters without prior registration. In light of the substantial Commission experience with such offerings, it was felt that the time had come for the Commission to develop, by rule, a specific set of standards affording greater certainty to such offerings and eliminating the present, individualized, no-action process.

A substantial number of foreign broker-dealers have established themselves in the United States, directly or through affiliates. In the recent past, the major exchanges and the National Association of Securities Dealers have been persuaded to allow many such entities to become members. The 1975 Amendments to the Securities Exchange Act inhibited any effort on the part of American self-regulatory organizations to require reciprocity on the part of their foreign counter-parts as a condition of membership. At the same time, many American broker-dealers and underwriters have encountered serious obstacles in attempting to compete in be important foreign capital markets. Accordingly, it was strongly suggested that the appropriate agencies of the United States Government should be urged to take steps to assist American securities firms to obtain appropriate access to foreign securities markets and business, particularly in view of the substantial steps which have been taken to open up the American securities markets to firms headquartered in such foreign markets.

There was a general consensus that it would be appropriate for the Commission to take notice of the important fact that the relationship between banks and broker-dealers is now under review by the Congress when considering the question of the entry of foreign broker-dealer subsidiaries of foreign banks to do business in or the United States.

It was the general view that protections to American citizens purchasing or selling foreign securities abroad were necessarily limited. The Commission should make it clear to persons who, while abroad, purchase or sell foreign securities that investor protection standards in foreign countries are, in general, substantially less strict than those applicable in the United States.

IV. ACCOUNTING AND AUDITING STANDARDS

The Adequacy of Generally Accepted Accounting Standards

While there were variously expressed reservations on the part of some participants as to the adequacy of generally accepted accounting principles ("GAAP") as they exist today, it was the prevailing feeling that there was no better alternative to GAAP available and that it should be considered a living and changing body of principles that constitutes an appropriate framework for the fair presentation of financial statements. The re-examination of the conceptual framework for financial reporting presently being undertaken by the Financial Accounting Standards Board ("FASB") is considered an important project. It was the sense of the Conference that there was a need to apprise investors of the inherent lack of precision in the numbers contained in financial statements and that exclusive focus on single bottom line figures, such as earnings per share, is unjustified. There should be further emphasis on other important information within and outside the financial statements, such as competitive conditions, industry trends and other information.

The Conference considered the question of whether GAAP should require uniformity and minimize the possibility of alternative accounting treatment. Some participants urged greater disclosure with respect to alternative accounting treatment. A consensus was reached that continuing efforts should be made to reduce the number of accounting alternatives so as to achieve greater comparability across companies. A strong minority view was expressed that consistency of application of accounting principles by a issuer between periods was more important than uniformity.

Considerable emphasis was placed upon the desirability of independent audit committees on the boards of directors of reporting companies. It was urged that the establishment of such committees should be expanded beyond companies listed on the New York Stock Exchange, where such a requirement has recently been imposed.

The Formulation of Accounting Standards

With respect to the formulation of accounting standards, it was the strong feeling of the Conference that this function should remain with the FASB in the private sector. There was general satisfaction that the FASB was independent of the practicing accounting profession and of issuers of financial statements. There was also a strong feeling that the three years of life of the FASB was too short a period within which to evaluate its work.

Strong doubt was expressed that the government could perform the function of the FASB any better. The general view was that transferring the function to the government would not in any way reduce the complexity and inherent difficulty in the formulation of accounting standards. Concern was also expressed about the extent of political influences (including those for special interests, or a desire to implement or reinforce national economic policies) that would be likely to be brought to bear upon the setting of accounting standards were they set by the government.

While a number of participants in the Conference thought it desirable that "Sunshine Act" procedures should be employed by the FASB in its decision making, others felt that the current procedures of the FASB (publishing a discussion paper, issuing exposure drafts and conducting hearings before promulgating a final statement) were preferable. The insulation of FASB members from any external pressures at the juncture of decision making was believed by some participants to be beneficial.

A number of participants at the Conference believe there is a need to educate the Congress and the public concerning the complexity and function of accounting and the existing procedures for the setting of standards. There has been a failure to communicate effectively an understanding of these matters. The relatively recent indications that members of the FASB were speaking out concerning the role of the FASB and the basis for their decisions is a development to be encouraged and should be continued and expanded.

The operations of the FASB are funded by a foundation that raises monies from the accounting profession and issuers. While no member of the FASB or its staff participates, or is called upon to engage, in fund raising, there was the belief on the part of a number of participants that consideration should be given to a manner of funding the FASB that would be based upon long term commitments for voluntary contributions.

It was the consensus of the Conference that the present posture of leaving the development of such standards to the FASB with oversight responsibilities in the Commission is appropriate. The Conference understands that the accounting staff of the Commission keeps the Commission informed of matters being worked on by the FASB, and that the Commission, with the advice of its accounting staff, is in a position to take exception, where warranted, to the standards being proposed by the FASB. While some participants believe that there should be a greater degree of Commission involvement in the process, and possibly the creation of a self-regulatory framework involving the FASB, it was the consensus that this was unnecessary.

The Formulation of Auditing Standards

With respect to the formulating of auditing standards, it was also the consensus of the Conference that this should remain in the private sector. However, some participants questioned whether the present structure of the Auditing Standards Executive Committee of the AICPA is an adequate vehicle for the formulation of such standards. It was understood by the Conference that this matter is being studied by a special commission,

and any decision with respect to this matter should await the recommendations of that commission.

Cost-Benefit Analysis

The consensus of the Conference was that, whether accounting and auditing standards are established by the FASB or the Commission or some other body, innovations in such standards should be considered and analyzed in light of their cost to issuers and that such analysis should be a systematic part of such consideration.

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Hyatt Regency Washington
Washington, D.C.

Agenda

All Conference functions will take place on the Conference Level or in Conference Parlors at the Hyatt Regency. Specific rooms will be posted on bulletin boards in the hotel lobby and on the Conference Level close to the registration desk.

Thursday, January 13

6:00 p.m. -- Welcoming Reception

6:45 p.m. -- Guests please be seated for dinner.

6:55 p.m. -- Welcome and introduction of Keynote Speaker by The Honorable Roderick M. Hills, Chairman, U.S. Securities and Exchange Commission.

7:00 p.m. -- Keynote Address by The Honorable William E. Simon, Secretary of the Treasury.

7:45 p.m. Dinner

Friday, January 14

8:30 a.m. -- First Working Session --Agenda Topic One:
"The Most Appropriate Procedure for Creation of a New Policy and Standards With Respect to the Applicability of the Federal Securities Laws: Speeches, Panel Programs, Information Internal Guides, White Papers, Published Guidelines, Rulemaking, Warning Letters, Public Investigatory Proceedings, Adjudications, etc."

Groups A, B, and C, meet separately.

10:30 a.m. -- Break

l0:45 a.m. -- Second Working Session --Agenda Topic Two:
"The Impact of Trading Options an Market Making in the Underlying Securities, on the Capital Raising Capacity of Corporate Issuers and the Development of a National Market 'System."

Groups A, B, and C, meet separately.

12:45 p.m. -- Break

1:00 p.m. -- Lunch

2:00 p.m. -- Third Working Session -- Agenda Topic Three:
"What Can and Should the Commission Do to Maintain Investor Protection and Still Encourage the Internationalization of the Securities Markets?"

Groups A, B, and C, meet separately.

3:45 pm. -- Break

4:00 p.m. -- Fourth Working Session -- Agenda Topic Four:
"What Should Be the Relationship Between the Commission and the Private Sector With Respect to the Setting of Accounting and Auditing Standards?"

Groups A, B, and C meet separately.

5:45 p.m. -- Break

6:30 p.m. -- Reception

7:30 p.m. -- Dinner

8:30 p.m. -- Remarks by Chairman Hills

<u>Saturday, January 15</u>

9:00 a.m. -- Corporate Disclosure Panel Discussion, to be led by Al Sommer, Esq. (All Conference Participants)

11:30 a.m. -- Break

12:00 p.m. -- Lunch

1:00 p.m. -- Plenary Session (All Conference Participants)

2:30 p.m. -- Conference closes

SEC MAJOR ISSUES CONFERENCE
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