

Reflections Of A Chairman

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I came to the Commission from the White House with the objective of furthering regulatory reform. During the prior 7 months I had served as Counsel to President Ford and as Chairmen of the White House Council for Regulatory Reform, with Alan Greenspan, then Chairman of the Council of Economic Advisors, as my mentor. He, the President, and I had been strong supporters of the Commission's May Day elimination of fixed commission rates earlier that year. Their belief and mine was that competitive commission rates would create more efficient stock markets and would inevitably lead to significant changes that would have substantial benefits for the broader capital markets. For this reason and others we believed it was important to add a significant capacity for economic analysis to the widely respected skills of the staff of the SEC.

One of my first goals, therefore, was to add an economist or two. My resolve to do so hardened when I learned that the three economists that were nominally on our staff were housed a few blocks away and were fully committed to assist the Department of Housing and Urban Development which was then headed by my wife.

I had quite a tussle with the Office of Management and Budget to get authorization for such hires. I really do not remember what we cut out of the budget but I do remember telling Alan Greenspan that I would trade in three lawyers and two automatic typewriters to hire Richard Zecher from the Economics Department of Iowa University who Alan had recommended, along with some staff. He, of course, thought I was making a great trade.

Dick then brought in Susan Philips, now Dean of the George Washington Business School and formerly a member of the Federal Reserve Board, from Brookings where she was an economics intern. The SEC then had what I believe was its first Office of Economic Analysis.

Over the next weeks we had Fisher Black and Myron Scholes, as well as Dick Zecher visit with various staff members about how economists look at capital markets and particularly about the role of options in the markets. It is fair to say, I believe, that the pilot programs we initiated, as a result of those discussions, were essential to the development of the organized trading we have now in standardized options. One of our last accomplishments, during my stay at the Commission, was approval of a pilot program in the trading of put options. It was a monumental accomplishment then to secure Commission recognition that puts are as useful as calls.

The indelible impression that I have of my first weeks at the SEC is of the quality, character and intelligence of the people with whom I was to be associated. My fellow Commissioners were extraordinary: 3 lawyers: Irv Pollack, the father of the Enforcement Division, Phil Loomis, the quintessential SEC General Counsel, and Al Sommers, one of the most respected securities lawyers in the country. I used to thank God for the Economist, John Evans. Without his support I don't think the other three would have taken me seriously. In fact, they were all tremendously supportive. They were willing to consider every idea, no matter how different, and answer any question I might have without chuckling about my ignorance. We had a large number of what one might call

“interesting days” during our months together, but I do not recall a single disagreeable moment.

There may have been a better staff before or after my time, but I doubt it. I spent a good and productive part of practically every day with Stan Sporkin, Harvey Pitt and/or Ralph Ferrara. No chairman ever had a better threesome in those jobs. There were so many others of such quality that I could not possibly list them all.

The most notable issue during our time, of course, was that incredibly long parade of companies embarrassed to disclose the questionable payments they had made to foreign officials. Hundreds of companies were forced to reconsider their policies. But, what a variety! There were some vulgar excesses: tens of millions of dollars paid to a Prime Minister to get business. Other payments, which we now euphemistically call “grease payments”, were perfectly understandable: money any of us would have paid to protect corporate property.

The common feature of most of them was that they were off book payments. They came from secret bank accounts; no one was accountable for the decisions. What we saw was an enormous breakdown in the audit process. We saw that there could be hundreds of millions of dollars siphoned off corporate balance sheets. The discovery that large corporate expenditures could be falsified and hidden seriously eroded our confidence in the existing regulatory scheme.

I have no real idea of how the media and political uproar of those days compares to that of the Enron era, but it was a big deal. Week after week a new bribery scandal was chronicled in headlines and provided grist from a Congressional speech.

As Congress and the media railed at big business, a significant number of lawyers, accountants, business men and commentators severely criticized us for requiring disclosure of corporate political payments which they argued were not material transactions relative to the size of large corporations. We were even chastised by a Presidential Committee appointed to look into the bribery cases.

Eliot Janeway's publication put it succinctly:

“The SEC's new experiment in righteousness is about to backfire.

It will register more laughter than sales.”

At the same time Congress, spurred by a Ralph Nader book, was giving serious attention to a bill that would have required all large corporations to be federally chartered and subject to stringent regulation.

To some of us at the time it brought to mind the “Charge of the Light Brigade”:

“Cannons to the right and cannons to the left.”

We believed they were all missing the point. Our responsibility was for the integrity of the books and records of publicly traded companies and with the transparency of corporate conduct. In meeting that responsibility we took three steps, which in hindsight, seem pretty simple:

- We adopted the Commission’s first comprehensive rule requiring reporting companies to have strong internal financial controls;
- We caused the Executive Committee of the American Institute for Certified Public Accountants (“AUDSEC”) to impose new auditing standards that would require auditors to bring all questionable items to the attention of someone independent of the suspicion; and
- We persuaded the New York Stock Exchange to require independent audit committees as a condition of listing.

I exchanged correspondence, on behalf of the Commission, with the NYSE’s Chairman. Copies of those letters were passed out on the floor of the United States Senate before voting occurred on the Federal Chartering legislation. Senator Percy told me later that several Senators withdrew their support for the bill because of the NYSE’s willingness to require independent audit committees.

It could be said that the modern view of corporate governance began with those steps. In some respect the Sarbanes-Oxley Act can be seen as an endorsement of what we sought with those regulatory actions 28 years ago:

- Section 404 is surely a strong enhancement of our decision then to require internal controls;
- The creation of the Public Company Accounting Oversight Board puts real teeth into the requirement of stronger auditing standards; and
- The mandate imposed on independent audit committees by the Act demonstrates that Congress, at least, believes that the requirement of independent audit committees is the foundation of sound corporate governance.

I hope my colleagues from that time take as much satisfaction from what we did then as do I.

In the relatively short time I was there we launched a few other initiatives. We created, I believe, the Commission's first affirmative action office headed then by Phil Savage. We also created an office for international issues to "coordinate the Commission's response to issues arising from the increasing internationalization of the securities markets, and [to] serve as Commission liaison with international organizations and securities regulators".

One of our more ambitious efforts was to launch a major computerization project. I came to the Commission with the Equity Funding scandal well in mind. The offices of that company were just above me in Century City where I was cleaning up an accounting mess at Republic Corporation. It seemed to me then, as it does today, that it must be possible to develop techniques of random access to corporate filings that would give the Enforcement Division solid reason to look at companies like Equity Funding. We hired Peter Shipman a computer wiz for those days to undertake the task. He accomplished a great deal and I trust that what he did do has provided some of the base for Edgar but we did not get the capacity for random access that I was seeking. The Commission still does not have it.

In January of 1976 we began a fundamental overhaul of the Commission's disclosure policies with the appointment of a distinguished advisory committee headed by Al Summers with members such as Warren Buffett. Al continued to chair the committee after he left the Commission. The Summers report is considered by many as a landmark event.

During my last few weeks at the Commission we convened "The SEC Major Issues Conference" with 64 well-informed conferees, including several former SEC Chairmen, along with prominent representatives of public interest organizations, investment and commercial bankers, law professors, lawyers, accounting professionals and government officials.

With all members of the Commission and much of our staff observing, the group, over a period of 3 days, took a serious look at:

- The manner in which the Commission had been articulating its policies;
- The initiatives we had taken with respect to the organized trading of standardized options;
- Our interest in the internationalization of the securities markets; and
- The attention we had given to accounting and auditing.

The overall endorsement of this group of the course we had set on those four issues was, for me, a pleasant way to end my time at the Commission. David Ruder and Brad Cook were among the 9 previous or subsequent SEC Chairmen that participated.

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