A VIEW FROM THE SEC

John R. Evans*

Our constant effort at the Commission is to protect investors by requiring full and fair disclosure of the nature and character of securities, promoting equitable, fair and efficient securities markets and preventing fraud in the sale of securities. We attempt to accomplish these goals, which are vital to the functioning of our corporate free enterprise system, through a unique regulatory framework which maximizes the contribution of securities industry self-regulatory organizations such as the National Association of Securities Dealers and the exchanges, the private accounting profession, the securities bar and the business community.

Although the Commission is reputed to be the best regulatory agency in Washington, there are those who believe that we rely too heavily on private organizations and that our responsibilities could be fulfilled better through more direct regulation and enforcement by the Commission. I must admit that sometimes the unwillingness or inability of private firms and organizations to bring about changes which we believe are needed is disappointing. While it may be necessary for the Commission to become more actively involved in some issues, I firmly believe it is most appropriate that the protection of investors and improvements in our securities markets and

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even the preservation of our private corporate form of business continue to depend largely on the activities of the corporate community itself, industry self-regulatory organizations and private accountants and attorneys.

One of the major issues before the Commission at this time, as discussed by Gordon Macklin at the beginning of this seminar, is what we should do to facilitate the development of a National Market System for securities in which there will be efficient best execution and opportunity for all participants to compete fairly.

There presently exist exchange rules which do not permit these congressionally-mandated objectives to occur with respect to listed securities. Two years ago, when Congress enacted legislation to facilitate the establishment of a National Market System, the conference committee report stated that it was "the intent of the conferees that the National Market System evolve through the interplay of competitive forces as unnecessary regulatory restrictions are removed."

The Commission was directed specifically to review exchange rules which limit or condition the ability of members to effect transactions in securities otherwise than on exchanges. The Commission made such a review and determined that the rules were anticompetitive. Against the strong opposition of exchanges we also required removal of the restrictions on certain agency trades and are now considering a proposal to remove the remaining restrictions.

That proposal is being vigorously opposed. There has probably been more opposition to this proposal than any I remember during the years I served on the Senate Banking Committee or during the years I've served at the SEC. The best argument some opponents have against the removal of off-board trading restrictions is that we shouldn't tinker with the best securities markets in the world, or that "If it ain't broke, don't fix it."

Obviously, these are not very compelling reasons to retain the status quo. If this rationale had been followed before NASDAQ came into being, there would be no NASDAQ. The over-the-counter system was functioning before NASDAQ, but it is functioning much better now.

Despite the fact that some arguments against removing off-board trading restrictions aren't very good, allegations that their removal will result in chaos in the stock market, make it more difficult for companies to obtain capital, or do irreparable harm to the nation's economy deserve and are receiving careful consideration at the Commission. Because these issues are presently the subject of consideration at the Commission, I will not get into specifics of off-board trading rules or suggest what the next steps by the Commission will be to facilitate the development of a national market system.

I can tell you that as an economist I believe economic change is generally brought about best by the operation

of competitive market forces rather than being determined by a government agency. Nevertheless, in our recent hearings on off-board trading restrictions the great majority of witnesses opposed the proposed removal of anticompetitive barriers and virtually every witness asked for greater SEC participation in structuring our securities markets. Due to the lack of progress made thus far by the private sector, you can expect us to respond to that request--regardless of our decision with respect to off-board trading.

Another segment of the private sector which is subject to limited SEC jurisdiction and is also in a state of flux is the accounting profession. Historically the Commission has strongly supported the concept of the private sector establishing accounting principles and practices. Recently, however, there has been growing dissatisfaction on the part of Congress, the SEC, and the public with the profession's performance and some well respected members of Congress have criticized the SEC's traditional posture of relying on the accounting profession. It appears to me that the profession is at a juncture where it must reform itself or else be subjected to extensive federal regulation. Following Congressional hearings earlier this year, the profession has established an SEC Practice Division of CPA firms within the American Institute of Certified Public Accountants which will require periodic peer reviews, auditor rotation within a firm, second partner review of audit engagements, certain public filings by accounting firms and the prohibition of certain management advisory services.

There will probably be many more controversial developments as the profession strives to meet the many challenges it faces. The Commission will do whatever it believes necessary to assure that financial information with respect to public companies is fair, accurate and meaningful. For the present, the SEC is supporting the profession's attempt to initiate effective changes, not only through public statements but also through rulemaking proceedings.

Earlier this month, we proposed rules to require disclosure in a company's proxy materials of the services provided during the last fiscal years by the company's independent auditors and the related fees, whether the board of directors or audit committee had approved all services, and other business relationships which a company may have with its auditors. We have also requested comments on the appropriate scope of services to be provided by auditors, consistent with their independence. In addition, the Commission proposed rule amendments which would require disclosure in a public report filed with the Commission and in the next proxy statement of the reasons for a change in auditors and whether the change was considered by the board of directors or the audit committee. The purpose of these two rule proposals is to make auditors more independent and the Commission continues to seek other ways to further strengthen the independence of auditors.

We believe it is desirable for all public companies to have audit committees composed of independent directors, and ways are being considered by which such committees might be encouraged or required. As part of our efforts to obtain appropriate disclosure of illegal or questionable payments and practices, we encouraged and supported the New York Stock Exchange in requiring that each listed corporation have an audit committee dominated by outside directors as a condition of being listed. This approach, which is being seriously considered by the NASD and other exchanges will, in my opinion, have a beneficial effect on corporate ethics and will be beneficial to shareholders.

This latter point is important because there appears to be a growing lack of investor confidence in corporate management and the entire corporate system is being subjected to intense scrutiny and criticism. The Commission has taken several steps intended, among other things, to restore investor confidence in the integrity of corporate management. In August we issued a major interpretive release emphasizing our long-standing view that the Federal Securities laws and our present rules require the disclosure of all forms of management remuneration, including salaries, fees, bonuses, and certain personal benefits frequently referred to as perquisites.

The Commission has also undertaken an examination of our disclosure system and a re-examination of shareholder

communications, shareholder participation in the corporate electoral process and corporate governance generally. The ultimate resolution of these initiatives, neither of which, in my opinion, has received the attention it deserved, may have far-reaching consequences.

In February of 1976, the SEC appointed an Advisory Committee on Corporate Disclosure to examine the entire disclosure system and to make recommendations for legislative and administrative changes, if necessary, better to fulfill the needs of investors. The Committee was composed of attorneys, accountants, analysts, academicians, financial executives and others having experience with the corporate disclosure system. The Committee was challenged with difficult, if not impossible, objectives. Its initial task was to define the purposes and objectives of a corporate disclosure system. It sought to identify more precisely those who make investment decisions, the information they actually use in making such decisions, the extent to which such information is found in or secured from Commission files and from documents required to be prepared and distributed by the Commission, the means by which users secure such information, the validity, accuracy and credibility of the information used and the types of information neither presently available, or widely disseminated which such investment decision makers would find helpful.

The Committee's final report is scheduled to be submitted to the Commission shortly. One of the more interesting aspects of the report, is its Individual Investor Opinion Survey which is based on 4,922 responses to questionnaires that were sent to 11,574 investors in 15 public companies. The surveyed investors rated future economic outlook of the industry involved as the most useful information in their investment decision; second in importance was corporate financial statement information; third, information about a corporation's products and markets; and fourth, information about the quality of management. Not surprising was the finding that the annual report was well read and was found to be the chief source of information for making investment decisions. I urge you to obtain a copy of the final report when it becomes available and consider the implications of the survey, which in my opinion tend to suggest that the typical investor is rather sophisticated. This conclusion would seem to bolster many of the Commission's recent disclosure rules, particularly with respect to financial statements, segment reporting and quality of management.

Some of the recommendations in the report, which may be of particular interest to participants in this conference will be:

> The development by the SEC of industrywide disclosure guidelines;

> The increased use of projections and other soft information which would not be subject to ordinary liability provisions of the securities laws;
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> Encouraging the disclosure of management plans and objectives and of planned capital expenditures;
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> Encouraging disclosure of corporate policies on dividends and debt ratios;
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> The development of a uniform, streamlined SEC reporting form;
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> Classifying public companies so that so-called small companies will not be immediately subject to new SEC disclosure requirements and, in fact, may be relieved of some current reporting requirements; and
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> Requiring public companies to make all their SEC filings available to the public on request.

As you can see from the breadth of these recommendations, the Committee appears to be calling for more meaningful disclosure. No doubt some SEC critics and some early advocates of the Advisory Committee firmly believed that the Committee's research and empirical evidence would result in a significant curtailment of the SEC's current disclosure requirements. But it appears to me that the Committee has endorsed the SEC's present posture and is calling for expanded disclosure.

In my opinion, more and better disclosure of economic information alone will not restore confidence in corporate America. The response to a speech I gave last October entitled "Of Boycotts and Bribery and Corporate Accountability" has reinforced my belief that a growing segment

of our society is genuinely interested in so-called social disclosures, as distinguished from economic disclosure, which is what we have been focusing on during the 40-odd years of the life of the Commission. There is also increasing criticism of a corporate governance system in which management decisions appear to be rubberstamped by alleged independent directors and in which many stockholders seem not to have a meaningful opportunity to participate in major corporate decisions.

I concluded my remarks last October by stating that the Commission should reevaluate all of the proxy regulations to determine whether they promote the corporate democracy envisioned by the Securities Exchange Act of 1934. In addition, I stated my belief that the SEC must more actively promote both improved disclosure of corporate transactions and more meaningful corporate democracy in order to make directors and executive officers of public companies more responsive to the stockholder owners of those companies.

The Commission has now begun such a broad re-examination. Although I recognize that a perfect corporate democracy may not be possible, I am hopeful we can make significant progress towards that goal. On April 28 the Commission formally announced a re-examination of all its rules relating to shareholder communications, shareholder participation in the corporate electoral process and corporate governance generally and requested written comments preparatory to holding public

hearings. The response to that release has been encouraging. We have received about 160 letters of comment from persons representing a broad range of interests and advocating a wide spectrum of viewpoints.

Public hearings began on September 29 in Washington and additional hearings will be held in Los Angeles, Chicago and New York. On the first day of our hearings we heard from a number of witnesses, including Senator Howard Metzenbaum, Chairman of the Subcommittee on Citizens' and Shareholders' Rights and Remedies of the Senate Judiciary Committee, two law professors, the Chairman of the Federal Trade Commission and representatives of the American Society of Corporate Secretaries.

Everyone agreed that some reform was necessary, except the American Society of Corporate Secretaries, which stated its opposition to virtually every proposal for reform included in the Commission's release and concluded that "the present system is working and there is no need to make any significant changes at this time." In contrast, other witnesses had statistics with respect to lack of opposition candidates to incumbent management, the lack of success when there were opposition candidates, and made a number of suggestions to improve corporate governance. Members of the Commission expressed varying degrees of disappointment with the Corporate Secretaries' testimony that the corporate governance process was self correcting and was working well.

I believe Chairman Williams expressed our feelings well by indicating his disappointment that an organization which he thinks should be showing some leadership and initiative is so sanguine with the effectiveness of the present corporate governance process. I gave my view and will give it again here today, that you probably won't find a government agency that is more interesting in assuring that our private enterprise system continues to operate properly. We are here to protect investors. We are here to protect the markets. We are here to see that you have an opportunity to get capital in those markets. Our purpose is not to be critical but to make the system work better and we are concerned for the future of the corporate system if reforms are not undertaken.

Improvements can be made. I hope you will participate in our hearings, and in so doing will give us the benefit of your experience with respect to what you are doing or would recommend to increase opportunities for shareholders to participate in corporate governance without jeopardizing the ability of management to properly perform its functions.

In conclusion let me quote from Senator Metzenbaum who said:

> The modern corporation is under severe criticism. Reform is in the air and will come. History is full of examples where those in power failed to recognize and embrace some moderate changes only to be confronted later with more drastic measures which they could not then resist.

We may well be at the threshold of examining the future of corporate America. I encourage you to participate in this momentous undertaking.