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AN ADDRESS BY

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Under normal circumstances, a law enforcement agency that finds well over 100 large companies that appear to have hundreds of millions of dollars of questionable or illegal payments; that successfully prosecutes actions against nearly a score of them for violations of federal law; that causes restitution of millions of dollars to the shareholders; and that prompts numerous other major companies to institute codes of good conduct would expect a certain amount of praise.

But let me read a bit of our fan mail. Eliot Janeway says:

> The SEC's new experiment in righteousness is about to backfire. It will register more laughter abroad than sales.
>
> Washington's cleanup code for corporations under pressure to pay off abroad is reducing America to a role of a pitiful, helpless giant. There's no way to compete for foreign business without being prepared to pay off to get it."

And from a distinguished Washington lawyer and former SEC staff member:

> "What function remains for the SEC here? I submit; none."

To keep us in balance however, it is clear that many others are equally fervent in their belief that we have not done enough.

Congressional leaders and public commentators have proposed new laws:

-- One Senate bill would make it a federal crime for any person to make any payment to a foreign official or foreign political candidate for the purpose of obtaining or retaining business or influencing foreign legislation or regulations.

-- Other proposals would provide federal rather than state charters for our large corporations.

-- Others would require appointment of public directors to the boards of private companies to protect the public interest rather than the interests of the stockholders.

The White House Task Force suggests rather complete disclosure of all foreign political contributions and payments, legal and illegal, to an executive branch agency, but suggests a period of a year or so before they are made public.

Probably no single topic has consumed more of our attention at the Securities and Exchange Commission over the past year but certain basic questions seem to appear time and again:

> Have we uncovered a growing cancer at the core of American business that must be removed with extensive government action, no matter what the cost; or are we naively depriving American corporations of the capacity to do business abroad?

And just to complicate things a bit more:

> Is it really any of the SEC's business anyway?

It has always been hard to be on the "right" side of the bribery issue. At the moment, I think the Commission stands somewhere near the middle. I also think the debate over the SEC role has missed the point.

WHAT HAVE WE FOUND?

In May, the Commission completed and submitted to the Senate Committee on Banking, Housing and Urban Affairs a report that analyzed the public disclosures made by some 95 companies regarding actual or potential problems stemming from questionable or illegal payments and practices, both foreign and domestic; including a discussion of the 14 actions involving the same subject that had been instituted by the Commission at that time.

We pointed out that some corporations had disclosed annual payments of millions of dollars while others showed relatively small payments. Some payments were designed to cause illegal actions by government and business officials, but some were to persuade persons to perform functions that they were supposed to do without "tips." Some were authorized, or at least condoned, by top corporate officials who permitted corporate books to be distorted in order to deceive some directors, especially the outside directors, as well as the lawyers, accountants, and shareholders. Some payments were understandable reactions to low or high level extortion; others were intentional and vulgar examples of corporate arrogance.

Since that time the numbers have changed, but the basic nature of the reported practices have not. The number of companies that have made public disclosures of matters of this kind is now just under 150; our relevant enforcement actions on matters of this kind now number 17.

Our report to the Senate I believe is the principal starting point for all those who wish to deal with the problem.

WHAT DOES IT TELL US ABOUT AMERICAN BUSINESS?

Of the thousands of publicly-traded companies, fewer that 150 have admitted questionable payments, and a much smaller number, probably fewer than 20, revealed large lump sum payments that appear to have been bribes designed to obtain business.

As uncomfortable as it is to talk of degrees of impropriety, the distinction between the bribery of a government official to secure a large government contract that would otherwise have gone to a competitor and a payment to an official to make him do what he is supposed to do without it is obvious. Compare, for example, an airplane manufacturer that pays millions to get a contract away from a competitor with an importer who pays thousands of dollars to persuade the local police to guard warehouses or to get port officials to permit its goods to be shipped in or out of the country. Compare the bribe of a chief of state to change the country's tax laws with political contributions that are entirely legal in the country where made.

My point is a modest one: taken as a whole, these incidents have not revealed some new low of corporate morality. Kickbacks, embezzlement and large gratuities have been some part of the commercial scene for centuries. Indeed, a thoughtful analysis may well indicate that since the turn of the century there has been an improvement in the quality and morality of corporate management.

HAVE WE FOUND IT ALL?

Since over 9,000 companies file with the Commission, it is safe to say there will be more disclosures to come as the year continues. Obviously, some companies have revealed their problems in greater depth than others. Some have made no disclosures and probably will continue to chance it. They may stop future payments and never tell us about the past. And of course we expect that some corporations will attempt to

continue their practices and conceal them from some members of top management and the board of directors, from their independent auditors, and from us as well.

Finally, as Secretary Richardson correctly pointed out, there is a universe of private companies that engage in foreign business that do not report to the Commission.

Notwithstanding these acknowledged limitations, I think it is safe to say that we have the measure of the problem. The disclosures that have been made, catalogued, and reported provide a fair picture of the range of problems subsumed within the general phrase "questionable and illegal foreign payments." I think that we now have a sufficient body of data to reach some conclusions about public policy considerations.

WHAT IS THE PROBLEM?

Is the Commission "plainly out of its ballpark?" Are we operating in areas in which we have neither competence nor legitimate concern? Are Pat Buchanan and others correct when they claim that Lockheed and others had to bribe to get business? Are we operating in a manner that is subject to serious legal question?

The charge is that we have so stretched the concept of materiality that we are forcing public companies to make disclosures that are simply not material in any common sense understanding of the term.

But let me say with some fervor that materiality was obviously present with all of its trappings in each of the 17 cases that have been filed. Let me take as examples the complaints against three companies:

-- In the case of one, we charged that about $25 million was given in secret payments to government officials to obtain business rather than for the purpose stated on company books.

-- In the case of another, we contended that the company established and maintained numerous off-book funds through which millions of dollars of corporate funds were passed and used for substantial improper and illegal payments.

-- We charged that corporate books and records were systematically falsified to disguise slush funds;

-- Against a third, the Commission charged that the company maintained funds not recorded on corporate books and records and that it falsified other records and transactions to disguise the source and use of the funds;

In each case we charged that the nondisclosure of these and other matters constituted violations of the federal securities laws.

The point is that in these and other cases:

-- Some members of the board of directors, and especially the outside directors, say they did not know about these practices;

-- the auditors say that they were unaware of these matters as they were going on; and

-- investors and shareholders were not informed of material facts regarding the conduct of the corporation and relating to the integrity of its system of corporate accounting and to some members of top management.

These are legitimate issues of concern to the Securities and Exchange Commission.

Equally important is the fact that those who continue steadfastly to maintain that this entire subject is not one of legitimate Commission concern miss the point of our

present posture. Regardless of the theoretical merits of those arguments -- and I personally am not persuaded by them -- the fact remains that the Commission has long since opened the cage. Some of the beasts that emerged have dismayed the American public, enraged some of our foreign allies, and raised a level of concern in the Congress that will not go away until we have dealt with the problem in an effective and convincing manner.

The question at this point is not whether we should be inquiring into matters of this nature. Rather, the real question to be addressed now is, "Where do we go from here?" Is the matter in hand -- has the SEC demonstrated its competence to deal with the problem or is there far more to be done?

WHAT ARE THE SOLUTIONS?

We can assert with some assurance and only minor exceptions to date that the companies reporting questionable and illegal payments have taken effective measures to stop them. Many have completed their investigations of past conduct and have established codes of conduct and workable standards and procedures to prevent repetition. Those few companies that have indicated an intention to continue some payments are dealing essentially in area of grease and facilitating payments, responses to demands or pressures for payments for consideration or services to which they should be entitled without "tips" of this kind. Even those companies have generally tightened their own internal controls and have indicated that such payments will be considered at the highest levels of corporate authority and will be made only when no reasonable alternative is presented.

Equally encouraging is the response of the major accounting firms, which now make greater efforts to detect possible problems and call their existence to the attention of top management and to the boards of directors. Recently the Auditing Standards Executive Committee of the AICPA issued an exposure draft that would require auditors to look carefully for signs that their clients may have engaged in illegal acts, to conduct thorough examinations when the circumstances suggest that such problems may exist, and to bring to the attention of a level of management that is high enough to take effective corrective measures.

The independent directors now recognize far better their obligations. They surely know that they have, in effect, an affirmative obligation to question both management and outside auditors on the matter of questionable payments.

I think that we also have engendered an increasing recognition in the business community that the actions of some have tainted them all, and that American business now must take effective steps to put its house in order and to persuade the world that it has done so.

All this has been accomplished under the federal securities laws, which require that investors and shareholders be advised of material facts relating to the business of corporations and to the integrity of its top management and that effective books and records be maintained by publicly held companies. The effective byproduct of our demand that corporations establish internal systems that are adequate to bring to the attention of top management facts that may be material under the federal securities laws and the resulting disclosure of material facts has been the termination of many of these practices. We do not shrink from this consequence.

As I see it, the primary significance of our actions has been to cause more effective self-governance by the corporations involved. Repeatedly we have discovered instances in which a small number of corporate officials, operating in relative isolation and not revealing their operations to other members of top management or the entire board of directors, have engaged in practices that eventually have led to the profound embarrassment of their companies and, in some cases, their country.

In the actions we have initiated, the Commission has caused the corporations to conduct exhaustive investigations of their past behavior and to report their findings to the court, the Commission, and to investors and shareholders. The chief executive officers of several of these corporations have been replaced. Audit committees consisting of outside directors have been installed, and in general, the corporate governance has been significantly changed. The result has been to secure both a purge of past misbehavior and to obtain a change in corporate accountability that will provide reasonable assurance that similar misbehavior will not be repeated.

Let me say once more with emphasis the most troublesome aspect of the cases we have examined has been the repeated frustration of corporate accountability.

In response to their problem, the Commission has proposed legislation which would

-- Require management to establish internal controls that would reasonably assure that financial transactions are properly identified and recorded;

-- Prohibit the falsification of any corporate accounting records; and

-- Impose liability on corporate officers who make false or misleading statements to their auditors or

> who otherwise cause the financial condition of the corporation to be presented falsely.

The Commission intends to supplement this requirement by promulgating rules that would require auditors to report on the adequacy of the system of controls that would be mandated by this statute.

The Commission has also requested the New York Stock Exchange to consider amending its listing requirements to require each listed company:

-- To maintain an audit committee composed of independent directors, with full access to all information and regular private meetings with the outside auditors;

-- To increase the number of outside directors on its board generally and, for certain companies above a certain size, to consider requiring that the board be composed of a majority of outside directors; and

-- To exclude from the board of directors lawyers who are also responsibility for giving general legal advice to the company.

Similar actions already have been taken by many large companies, but the institutionalization of these requirements by the New York Stock Exchange could bring about a major improvement in the attention given to the conduct of management by corporate boards.

These proposals, together with the actions already taken, give me confidence that the response meets the problem presented, at least so far as it impacts on the federal securities laws.

For that reason, the Commission has asked that the Congress not amend the federal securities laws to impose a substantive prohibition against payments of this kind. Such legislation is unnecessary and would represent a significant departure from

the tradition relationship we have enjoyed with registered companies and companies that file with us.

In our report to the Senate we took note of a further point. Companies will be concerned on occasion with whether or not to disclose some form of questionable payment -- we said there will be times, perhaps many, when we will not be able to give comfort to a company that believes a given payment is obviously immaterial, yet obviously improper in some other country. The unforeseen consequences of such payments are too great to shift responsibility to the Commission.

In such cases companies with proper internal accounting and accountability to their own boards will simply have to take the burden of such decisions.

This, we believe, is the proper allocation of responsibility.

WHAT IS THERE LEFT TO DO

As I see it the steps we are taking and have proposed will eliminate the so-called big bribe by officials of publically owned companies excepting only the most cavalier and unscrupulous of persons.

We will also have imposed a far greater discipline on corporate management with respect to the lesser payments -- there will in fact be far fewer payoffs of any kind, far less “grease” ladled out, and far greater resistence to all levels of extortion.

But the questions remain -- should more be done -- has too much been done?

With respect to the latter issue -- all the evidence in all the cases we have reviewed gives no basis for Mr. Janeway's claim that "we are sermonizing ourselves out of the export markets."

Bribery is not a material factor in the capacity of American business to compete abroad.

That does not mean that we should ignore the unfair tactics of foreign competition or the policies of foreign governments that tolerate such tactics. I will return to that point.

What more should be done? No doubt there will be efforts to place a comparable discipline on privately held companies and perhaps an effective mechanism can be created to deal with them.

Should we make it a crime for officials of public and private companies to use big bribes to divert business or to change laws? Such specific laws may give proper vent to our collective anger at the use of such payments, and if such a criminal law can avoid the confusion of payments that are questionable or foreign laws that are vague, there may be no reason not to criminalize such conduct.

But the SEC should not be required to enforce a prohibition on these payments. Our role is disclosure in such matters as I have said earlier.

Also, I seriously doubt that such a law would have any material effect on the behavior of corporate officials of companies, for as I have noted, such conduct by them will already be constrained by our existing and proposed policies.

Should we require federal chartering of major corporations and place so-called public directors on their boards? I see nothing to be gained by such changes with respect to the problem of bribery, and much mischief that can be done in other areas.

Should be require far greater disclosure of legal and illegal foreign payments in the manner suggested by Secretary Richardson's Task Force? Presumably the purpose of such a disclosure, even though delayed for a year, is meant as a warning to those who seek illicit payments that their name will be divulged.

I have no view now on this proposal which is not yet in proposed legislation -- I do think that it will not be terribly productive unless it is limited to payments made in countries that have entered into an agreement with the United States to require disclosure on the part of their own companies.

I do think that we can do more under existing laws to assist American companies that face the unfair competition of foreign companies that will bribe. And I would like to conclude by emphasizing this point.

Existing laws dealing with federal procurement of foreign goods, with our government's right to inspect the books and records of foreign suppliers; tariff laws providing for punishment of unfair methods of competition in the importation of goods, which permit the Secretary of the Treasury to investigate foreign competition that could weaken our internal economy; laws which even permit trade sanctions against countries that permit unfair tactics to be used against American business; and laws which authorize international agreements to eliminate distortion of international trade seem to me -- at least -- to provide both the weapons and the mechanism to give effective help to American business who compete abroad.

American companies should demand that these laws be used to assist them with their problems abroad, and I am hopeful that our government can develop effective channels of communication to make it clear both to American companies and foreign competitors that these laws will be used.

Whatever we attempt, we should very much evaluate the art of the possible in changing behavioral patterns of centuries. Much has and can be accomplished but we should not pass laws that cannot be enforced for their symbolic value or seek major changes in our system of corporate regulation.

We saw as a nation recently with respect to the scandals of Watergate that our system of government works.

We do now have a respected national government.

We can say the same with respect to our securities laws. They did work and with a few changes of the nature we suggest, we can have confidence they will continue to work and we can restore the damage that has been done to the public confidence in our business community.