Statement of the
National Association of Manufacturers
to the
Senate Committee on Banking, Housing and Urban Affairs
on S. 305
A Bill to Amend the Securities Exchange Act
March 16, 1977

The National Association of Manufacturers is a voluntary, non-profit organization of over 13,000 companies, large and small, located in every state of the Union. As the representative of firms which account for nearly 85% of American manufactured goods and the employment of approximately 15 million persons, the NAM is concerned that a number of corporations have made questionable or illegal foreign payments. NAM's Board of Directors has called upon member companies to adopt individual codes of ethics and to adhere to the highest standards of business conduct. The Association has also favored strict enforcement of current laws and U.S. Government proposals for an international agreement to prevent improper payments in world commerce.

NAM believes that continued development of more effective internal corporate controls, improved enforcement of U.S. laws and the undertaking of successful international negotiations constitute positive and effective steps toward this problem's resolution. We are not convinced that further unilateral U.S. legislation is necessary. Further, we believe that action such as proposed by S. 305 would pose serious problems of extraterritorial enforcement, particularly regarding constitutional due process guarantees, and may prove counterproductive to the achievement of an effective multilateral accord. We therefore oppose enactment of S. 305.

Background:

The issue of improper payments made overseas by some U.S. companies received widespread publicity in 1976, stimulating a policy debate on necessary corrective actions. A series of steps were undertaken at three different levels to meet the perceived problem and help assure both its immediate and longer-term resolution. The first area of response has been in self-corrective and preventative actions by companies themselves. We continue to believe this approach to be both the most logical and effective means to deal directly with the problem. The NAM Board of Directors urged member companies to adopt individual codes of ethics and adhere to the highest standards of business conduct. In an open letter to the membership on April 19, 1976, former NAM Chairman Richard C. Kautz pointed to the NAM Code of Business Practices which states, in part, that 'We will compete vigorously to serve our customers and expand our business, but we will avoid unfair or unethical practices." Individual company management is in the best position to take the leadership in making commitments, defining derelictions and applying censure and penalties to those who violate standards. Management is sensitized to the problem of improper foreign payments and the actions it has taken speaks well for private sector self-correction, including vigorous investigations of past payments, increased vigilance by directors, audit committees and outside accountants; and strong corporate leadership statements of policy coupled with tightened internal control procedures.

New governmental enforcement procedures under current law have also been undertaken by a number of agencies. The Securities and Exchange Commission (SEC) was at the forefront of initial disclosures of improper payments and is, of course, continuing to enforce regulations as applied relevant to publicly-held companies. The Treasury Department instituted procedures to investigate corporate payments abroad which might involve U.S. tax laws. A special Presidential

cabinet-level task force conducted a study of the problem and last year recommended a new reporting and disclosure approach to supplement these other Executive Branch actions.

Two measures were passed during the 94th Congress which bear directly on this subject. One bill established reporting requirements on payments involving military sales and the other designated tax penalties which would be applied in cases of foreign bribery. Proposed legislation to cancel Overseas Private Investment Corporation (OPIC) coverage on projects involving illegal payments passed the House but not the Senate, while the reverse situation pertained with regard to a Senate bill similar to Title I of the current S. 305 now before this Committee. Bills proposed by the previous Administration on the basis of the Presidential Task Force study which favored a reporting and disclosure system were not given full hearings in either House.

The third area of activity involved international efforts to deal with the payments problem. The United States concluded nearly a dozen bilateral information exchange agreements with foreign governmental agencies involving information to be used for investigations or judicial procedures in the foreign country. These agreements were negotiated so as to assure maintenance of proper Constitutional safeguards regarding judicial processes and information concerning individuals. The U.S. Government has also proposed to a special United Nation's Working Group the outlines of an international agreement to eliminate bribery from world commerce. The Senate has endorsed such a multilateral approach in Senate Resolution 265, passed unanimously at the end of 1975. Additionally, last year Senate Resolution 516 commended the OECD Guidelines for MNCs, including multilaterally-agreed voluntary standards on foreign payments which have been recommended by governments and widely accepted by multinational corporations.

Provisions of S. 305

The bill currently before the Committee, S. 305, has two separate titles which are summarized below:

Title I: "The Foreign Corrupt Practices Act of 1977"

Section 102 would amend section 13(b) of the Securities Exchange Act of 1934 by adding three new subsections.

The first new subsection imposes an obligation on specified corporate issuers of securities to maintain books and records that "accurately and fairly reflect the transactions and dispositions of the assets" of the corporation. In addition, it requires such corporations to "devise and maintain an adequate system of internal accounting controls sufficient" to assure that transactions are executed in accordance with management's authorizations, that transactions are property recorded, that access to corporate assets is controlled, and that corporate assets and records will be compared and reconciled at reasonable intervals.

The second new subsection makes it unlawful for any person, directly or indirectly, to falsify any book, record, account, or document maintained or required to be maintained by the corporate issuers specified in the first new subsection.

The third new subsection prohibits making materially false or misleading statements, or omitting to state material facts necessary to be stated, to an accountant in connection with any examination or audit of the specified corporate issuers.

Section 103 would add a new Section 30A to the Securities Exchange Act of 1934 to make certain foreign payments by specified U.S. corporations subject to the jurisdiction of the Securities and Exchange Commission illegal under U.S. law.

Such payments must have three elements. First, there must be a corrupt purpose in paying or giving, offering or promising to pay or give, or authorizing the payment of money or the giving of anything of value. Second, the corrupt payment or gift must be made to an official of a foreign government, a foreign political party or an official or candidate thereof, or an intermediary where the payor knows or has reason to know that the ultimate recipient is a foreign government official, political party, or candidate. Third, a payment or gift is made "corruptly" when its purpose is to induce the recipient to use his or its influence or to fail to perform official functions to direct business to any person or to influence foreign government legislation or regulations.

Section 104 would make such payments by any domestic concern not subject to the jurisdiction of the Securities and Exchange Commission illegal under U.S. law. This section provides criminal penalties for willful violation of a fine of not more than $10,000, or imprisonment for not more than two years, or both.

Title II: "Domestic and Foreign Investment Improved Disclosure Act of 1977"

Section 202 of the bill amends Section 13(d) of the Securities Exchange Act of 1934 to expand its disclosure requirements to include disclosure of (a) residence, nationality, and nature of the beneficial ownership of the person acquiring the securities and all other persons by whom or on whose behalf the purchases have been or are to be effected and (b) the background and nationality of each associate of the purchaser who owns or has a right to acquire additional shares of the issuer.

Section 203 of the bill adds a new subsection 13(g) to the Act. Paragraph (1) of the new subsection requires every holder of record of, and any other person having an interest in, 2% or more of any specified security to report such interest and other information in a form and at

intervals (but not more frequently than quarterly) as the Securities and Exchange Commission may by rule prescribe. Paragraph (2) of the new subsection empowers SEC to prescribe how the reports required by paragraph (1) shall be filed or published. It also authorizes the SEC to require issuers to include specific information received as a result of such reports in any filing or registration statement with the SEC. Paragraph (3) provides for gradual reduction in the 2% threshold of paragraph (1).

Paragraph (4) of the new subsection gives the SEC authority to exempt from the new subsection's requirements any security, issuer, or person, if it finds that such exemption is not inconsistent with the public interest or protection of investors. Paragraph (5) of the new subsection makes it unlawful for any person, in contravention of SEC rules, to make use of the mails or any other means or instrumentality of interstate commerce to effect any transaction (for his own account or the account of another) in any security subject of this new subsection if such person knew, or should have known, that information required to be filed or published in accordance with this subsection has not been filed or published. Paragraph (6) of the new subsection requires the SEC to consult with the Controller General of the U.S., the Director of the Office of Management and Budget, and of Federal authorities which require reports substantially similar to that called for by the new subsection in order to achieve uniform centralized reporting of such information and avoid unnecessary duplicative reporting by, and minimize the compliance burden on persons required to report.

NAM Position

The NAM continues to favor individual company codes of conduct and internal enforcement procedures as the most direct and effective method of dealing with this problem. Recognizing the global roots of improper commercial payments, we also favor the negotiation of

an international agreement to eliminate to the greatest practicable extent such payments from world trade. It is our opinion that steps being taken voluntarily by individual U.S. companies and the increased enforcement of current U.S. laws by agencies such as the SEC and IRS, have largely resolved the problem of such payments by American companies. The negotiation of an international agreement to eliminate improper payments worldwide would help assure that U.S. industry is not placed at a competitive disadvantage by unfair foreign practices as well as place world commerce on a better, market oriented trade and investment basis.

Evaluating S. 305 in terms of this position, NAM must oppose the bill for three major reasons: (1) corrective actions already taken have made passage of the bill unnecessary; (2) inherent problems in the bill, particularly regarding its extraterritorial application and conflicts with constitutional due process guarantees, make it either unworkable, threaten serious undesirable side effects, or both; and (3) the criminalization approach runs counter to U.S. proposals for an international agreement based on reporting and disclosure principles and could impair the achievement of such an accord.

New U.S. Legislation Is Not Necessary

An effective solution to the problem of improper foreign payments does not require the passage of new laws. Substantial legal sanctions are already in existence which are applicable to foreign bribery: in the Internal Revenue Code, the Clayton Act, the Sherman Act, the Federal Trade Commission Act, and the Securities and Exchange Act; in transactions involving AID or arms exports; and in shareholder derivative suits based on state and federal law. The reported cases of improper foreign payments indicate not a lack of law, but of enforcement, both from within and outside the company.

Corrective actions undertaken by corporate management and boards or directors, by the accounting profession, and by law enforcement agencies have all brought a closer security and tightened control of corporate funds expenditures. These actions have also been beneficially supplemented by the role of the news media in spotlighting wrongdoing and calling attention to the need for corrective measures in this area. The investigatory work of the press has created an awareness that actions bordering on questionable conduct run the risk of widespread public disclosure. The power of this very real constraint should not be underestimated, given the attendant possible repercussions on a company's foreign business, its vulnerability to legal sanctions, and certainly just as important, the damage to the firm's public reputation.

Corrective actions already undertaken in the private sector and the more effective enforcement of existing laws will, we believe, prove more than sufficient to resolve the payments problem without new legislation. What is needed now is not new laws dealing with U.S. companies, but rather an international agreement to assure that all businesses engaging in world commerce do so in a fair competitive manner.

Inherent Implementation Problems in S. 305

The major inherent implementation problem in S. 305 is its projected extraterritorial application which presents perhaps insurmountable practical enforcement difficulties and raises serious questions of constitutionality concerning due process guarantees. A case falling under the bills' prohibitions would involve a payment to a foreign government official, most likely on foreign soil, and perhaps by a foreign person. U.S. investigation of such incidents would inevitably raise national sensitivities and create diplomatic problems, making it unlikely that much official foreign cooperation with U.S. investigatory efforts would be forthcoming. However, without such full cooperation and support, the practical implementation of S. 305

would be nearly impossible since foreign witnesses and evidence would have to be obtained and transported to a U.S. court.

Official foreign assistance is even less likely to be available where the requestor is not the U.S. Government, but an accused defendant. Yet, under the U.S. constitutional system of justice, the defendant must have available to him adequate means to present his defense. Many U.S. persons accused of illegal acts under S. 305 will be unable to produce exculpatory evidence and/or witnesses from abroad because the reach of U.S. extraterritorial law is long enough to charge the defendant, but not effective enough to compel production of evidence and testimony necessary to his defense. This type of difficulty in providing due process in criminal cases brought under the proposal in S. 305 raises serious constitutional questions which should be resolved before the Committee takes further action on this bill.

Other implementation problems are also likely to arise under this bill. In the provisions dealing with payments through intermediaries, the standard of "or having reason to know" allows a very broad sweep for allegations and provides no recognition of the extremely diverse situations in which U.S. companies operate abroad. Business relationships overseas can range from transactions with a wholly owned subsidiary to a retained private consulting firm. Even at relatively high ownership levels there can be significant restrictions on a U.S. firm's access to documentation which might be necessary to carefully trace all expenditures to their final destination. Obtaining such documentation or information may be impossible when the intermediary is an independent contractor, legally separate from the U.S. company.

Overall, the bill raises serious due process and other constitutional problems and its practical implementation would prove difficult if not impossible to achieve due to understandable foreign apprehension and sensitivity to such a unilateral U.S. imposition.

An International Agreement is Needed

The desirability of an international agreement on bribery has been widely recognized and supported. Senate Resolution 265 called for the initiation of negotiations on such an agreement and subsequent initiatives were undertaken in both the GATT Multilateral Trade Negotiations and in the United Nations to seek an accord on preventing bribery. A special UN Working Group was established for this purpose and the U.S. has formally submitted a proposal to it outlining initial ideas on the substance of such an agreement. This Group is reportedly aiming at completing its report in time for the Economic and Social Council (ECOSOC) meeting in July and August of this year.

NAM favored Senate Resolution 265 and the negotiation in all appropriate international forums of a multilateral agreement to prevent bribery in international commercial transactions. The global scope of the problem argues for the participation of at least all major trading countries, if not virtually all countries worldwide, in cooperatively seeking the elimination of improper payments.

We believe that the general approach originally outlined by the U.S. Government before the United Nations Commission on Transnational Corporations and reported to this Committee by the former Undersecretary of State for Economic Affairs Charles Robinson on April 8 of last year constitutes a positive and operationally sound basis for negotiating an international accord. In particular, we believe the following elements could be included in a multilateral agreement: (1) All countries should clearly define procedures to be followed by companies dealing with the government in procurement or regulatory matters, including what actions would constitute illegal payments. There should be a commitment to effectively enforce laws against both bribery and extortion. (2) Inter-governmental arrangements, probably bilateral in nature, should be

considered to permit information exchange between governments, subject to necessary constitutional safeguards, to assist official foreign investigatory or judicial action involving illegal foreign payments. (3) An information reporting approach could be considered to assure that national governments have available to them the necessary information on payments to government officials in order to assist proper law enforcement and avoid possible foreign relations problems. However, such standardized reporting should be kept to the minimum necessary to meet these objectives.

The thrust of S. 305, on the other hand, runs counter to the objective of seeking an international agreement and may in fact jeopardize the negotiation of such an accord. First, the unilateral and extraterritorial nature of the legislation will likely foster diplomatic conflict rather than multilateral agreement. There is certainly no reason for the U.S. to forego steps to correct obvious shortcomings within its own jurisdiction as has been done by the many corrective enforcement actions already taken. However, to take such unilateral corrective action in a manner which extends far beyond U.S. borders into the internal affairs of other sovereign nations, can only raise potentially serious diplomatic conflicts with other governments, as has been amply demonstrated in the past in cases of U.S. antitrust and export control regulations. The extraterritorial enforcement of S. 305 would indeed raise problems far beyond the magnitude of past experience, for the enforcement would by definition directly involve investigation and judicial actions concerning foreign officials involved in government procurement programs or regulatory matters which take place on foreign soil. This type of unilateral U.S. action is not conducive to fostering the levels of international cooperation necessary develop a multilateral agreement on preventing improper payments.

Additionally, S. 305 is at cross-purposes with the basic thrust of the U.S. proposal for an international agreement which rests upon the clarification and effective enforcement of each nation's domestic laws on bribery and extortion, a system of information reporting and an inter-governmental information exchange network. By contrast, S. 305 seeks the extension of U.S. law into other countries, does nothing to reach situations of foreign extortion of U.S. companies, and does not advance the objective of enforcing laws against foreign as well as U.S. violators of bribery statutes. Any legislation passed by the Congress should be formulated in such a way as to encourage, not prevent, the achievement of an international accord dealing with the full scope of the payments problem and covering both U.S. and foreign companies.

Comments on SEC Proposals

Section 102 contains proposals originally made by the Securities and Exchange Commission relating to corporate record-keeping and misstatements to auditors. We believe that this section may be deceptively simple in its approach, but overly broad in application and potentially counterproductive in effect. In this connection we note objections to these provisions voiced last year by the American Institute of Certified Public Accountants (AICPA) and Committees of the American Bar Association and the New York City Bar Association. We are particularly concerned with the scope of the prohibitions, where even an omission in an oral conversation between an auditor and a third person could subject that person to criminal penalties. There is not even a requirement of specific intent to deceive contained in these provisions. We would also be concerned if the objections raised by the AICPA resulted, as they feared, in a diminished level of information flow from corporate employees and others to the auditors.

The SEC has, of course, put out for comment proposed regulations embodying the essence of Section 102. Since the responses to these proposed regulations were just due last Friday, March 11, we have been unable to evaluate the current judgments of persons with the most relevant expertise in this area. Therefore, we will refrain from taking a further definitive position on this section until it is possible to evaluation that material.

Comments on Investment Disclosure

Title II of S. 305 contains provisions which would provide for the filing of additional information by certain classes of beneficial owners of securities, over and above current reporting requirements. Reports would have to be filed by owners down to the level of 1/2 of 1 percent of certain classes of securities by 1979. While we have serious reservations about the need for such a provision and particularly about the benefits of such an extremely low ownership reporting level in light of the generally recognized need to reduce regulatory reporting burdens, we will defer detail comments on this Title at this time. Instead, we urge the Committee to refrain from enacting new legislation on this subject until the new SEC regulations soon to come in effect can be evaluated. The SEC has adopted beneficial ownership disclosure rules scheduled to become effective on August 31 which seek the same general objectives as Title II of S. 305, but with a relatively less burdensome format. The experience under these new rules, which were nearly two years in the making, should be evaluated before a new and more extensive system is legislated by the Congress.

Conclusion

The problem of improper corporate payments abroad has led to a number of self-corrective and preventative actions by the business community as well as improved governmental enforcement of U.S. laws. We believe that these steps have largely resolved the

problem of such payments by U.S. firms, but that an international agreement is needed to reach the full global scope of such payments. NAM supports both the continued development of effective internal corporate controls and the successful negotiation of a multilateral accord to prevent improper payments in world commerce. We do not feel that additional U.S. legislation is necessary at this time and specifically oppose S. 305. Primarily we feel that the bill would be impossible to effectively implement in a fair and consistent manner; it raises substantial constitutional due process questions, and it could lead to diplomatic conflicts counterproductive to the achievement of a desirable international accord on controlling improper payments.