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FINANCIAL INFORMATION AND
SEC POLICIES IN THE LIGHT
OF CHANGING NATIONAL PRIORITIES

An Address By

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Securities and Exchange Commission

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I appreciate very much this opportunity to appear before the New York Financial Writers Association. This evening I would like to assess the economic situation in which we find ourselves, the needs and the problems that lie ahead, and the role that you as financial writers and we at the SEC can play in meeting them.

We have passed through a troublesome period of economic and financial difficulty. Our national economy, our currency, the institutions of our capital market have paid a price for the over spending, the looseness and the shortsightedness of yesteryear. We can hope that the bill has been substantially paid, that we have relearned the lessons of balance and prudence and that we have a reasonably solid foundation from which to move forward.

To move ahead, we will have to mobilize large amounts of capital not only to meet the new needs of the future but to provide a more adequate equity underpinning for the large debt structure we have built up. This task will require a strong and efficient investment industry. We must put a high priority on maintaining as an important national asset the world's most vigorous and efficient capital market.

We will see an internationalizing of the capital markets. We will work harder to attract investment capital from abroad. Our money managers will look for opportunity in European and Japanese equities. This will increase the size of

investment markets in which they shop by about 50%--the value of European and Japanese equities being about half ours.

At home, we will indeed have to reorder our economic priorities sometimes to meet new needs and newly recognized needs, sometimes to re-establish the productivity necessary to keep us competitive in world markets. In reordering our national priorities the capital markets and the national budget are the primary tools. We can and should make the capital markets more sensitive and more prompt to recognize and respond to the really important new needs and more discriminating in providing funds for more ephemeral purposes.

As I see it, that is the broad perspective against which I would like to discuss the role you have to play, the role the SEC has to play, the role the machinery and the institutions which operate the American capital markets have to play. Then I would like to tell you about some of the things we plan to do to help all of us play our role more effectively.

The American capital market is the best in the world today because the investor in our market is the most informed and the best protected investor in the world. That is why a dollar of American earnings is worth a good deal more than a comparable amount of any other kind of earnings. That is why American companies can put most of their earnings into expansion while foreign companies have to pay out most of their earnings in dividends in

order to maintain their capital values. This is our principal advantage in raising living standards at home. As the other nations catch up to us technologically, our capital market becomes increasingly important to holding our own in international economic competition.

Investor confidence comes in part from our insistence on full and fair disclosure of information about companies and about the pricing and volume of trading in securities. It comes in part from your sophisticated and penetrating analyses of the information made available and your follow-up questioning of the sources of that information. It comes in part from the rules which the SEC and the self regulatory agencies have established to assure fair dealing in securities transactions. It comes in part from our enforcement activities and your reporting of those activities.

The quality of disclosure which we require and the quality of your reporting and analysis is important not only as the basis for investor confidence but also for its value in directing investment funds where they are most needed or, to coin a phrase, in reordering our economic priorities. It is just as important to direct funds away from companies which do not realistically face new needs and requirements and risks, and I will develop that in a few minutes.

As you know, I have not yet completed my second month at the Commission. But I have been there long enough to realize

that we of the SEC, 1400 strong with some 25 million dollars to spend are a very small band to protect the interests of 100 million Americans, 31 million of them directly owning securities and the balance participating in the equity markets through employee funds, life insurance and other institutional arrangements. We are a small band to supervise the disclosure practices of 7500 American corporations and transactions in the securities of another 20,000 corporations listed in the pink sheets. This can be accomplished only because the SEC stands at the center of an information and regulatory network in which you are a key ingredient. The rest of that network is made up of the bar and the accounting profession and the financial publishers and the exchanges and the other self regulatory agencies.

It's an important part of our job to help you play your role to the fullest both in terms of maximizing the availability of the information you need and in improving the quality and discernment of the disclosures made available to you.

Let me now review some specific steps we are taking in that direction. I know you have expressed concern about a blacking out of information during the period a company has a new issue in registration. I have read in the financial press that some companies whose securities are in registration have refused to

answer inquiries on the basis of SEC policy. Let me state as emphatically as I can that it is the purpose of the SEC to encourage disclosure of information not block it. It is true that companies in registration should not instigate publicity for the purpose of facilitating sales of securities in the proposed offering. It is also true that any publication of information by a company in registration other than by means of a statutory prospectus should be limited to factual information, and should not include predictions, projections, forecasts, or opinions. But there is no reason for a company in registration to refuse to respond to requests from the press for factual information about the company or some aspect of its business. Indeed if there are developments in the business which are material to investors a company is under a duty to make prompt disclosure. The fact that it has securities in registration does not excuse it from that obligation. Putting out information of a puffing character, misleading and designed to effect the selling price of securities is improper during registration or at any other time. The SEC certainly does not want to muzzle management or impose a blackout on disclosure of material developments during the registration process or to permit the registration process to be used as an excuse to withhold material information.

Let me stress how the disclosure process is vital not only

as a basis for investor confidence and judgment but also in directing the flow of capital to effect the reordering of priorities we hear so much about these days. I'm afraid it hasn't always worked as well as we are entitled to expect. If a man from Mars or an archaeologist of the 25th century found the offering circulars of the 1967 - 1969 period, how would the American society of our time be reconstructed. It could well be something like a string of communities made up of precut houses, with a nursing home and a hamburger stand on each corner, all hooked up by wire to a battery of electronic gadgets and fast food stores, synchronized by unbundled programs on leased computers. It is my personal view that the investor is entitled to something better than the usual boiler plate to the effect that there are strong competitors in the business. If the issuer has researched the market and analyzed the competition, the investor should be told what it found. If it didn't the investor should at least know that he's being asked to fly blind. At some point the investor is entitled to have the question raised as to how many fast food chains or bowling alleys can be financially viable. I believe better disclosure can accomplish this.

To turn to a more specific example of the impact of disclosure on economic priorities, let me tell you about the set

of guidelines we are developing on the disclosures a company should make in the light of increasing public concern about the environment. We will require disclosure of any material litigation against an issuer under the various air, water, and other anti-pollution laws. More than that, in the examination of filings made with the Commission, we will look to the nature and character of the business to see if significant capital outlays are likely to be required in order to eliminate pollution of streams or atmosphere or if significant product redesign may be called for to meet anti-pollution standards. The same kind of inquiry will be made with respect to the impact of safety standards on a company's product line. Where these problems potentially exist, the burden should be put on the company to represent that they do not exist or that they do not materially affect the capital needs or earning power of the business or to disclose their financial impact and the company's plans for dealing with it.

There are many other areas in which we are working to improve the flow of information available to investors. There is much to be done in achieving better disclosure of the economic reality in a business over and above that which is shown by its financial statements. Stimulated by the Lockheed disaster we are developing a set of guidelines to more fully bring out the risks and uncertainties in defense contracting. We continue to press

the principle that any corporate information which is material to investment values belongs to the investing public and that any use by insiders or those who receive private information which they know to come from insiders is fraudulent.

You as financial writers have a critical role in analyzing and projecting the information which is made publicly available, digging for additional information and putting it in proper perspective. The broker-dealer community has a heavy obligation in knowing and interpreting the information which you and we bring out into the light of day, and in knowing the financial needs and circumstances of their customers so that the securities they recommend are suitable to the customer.

And finally, together with the exchanges and the National Association of Security Dealers, we of the SEC carry the responsibility of enforcing all these rules.

We are constantly considering how best to implement our enforcement program in the light of changing circumstances and industry practices. Given our very limited resources, we have to divide our enforcement activity carefully between two principal areas. The first is the day-to-day fraudulent or manipulative activity engaged in by marginal operators. Due in part to the ease of entry into the brokerage business, there are at any given time a small but not inconsequential number of firms which engage

in high-pressure selling tactics, or churn customers' accounts, or persist in making a trading market in worthless securities. We take action against these firms, mainly through our regional offices, and enjoin them or revoke their right to do business.

The second area of enforcement activity involves the development of programs aimed at systematized frauds or illegal activities. These practices usually will have significant impact on many investors. Let me mention some areas where we have recently mounted major programs.

In a series of steps, the Commission "spiked" the "shell game". Promoters would acquire a defunct corporation with a substantial number of shares outstanding in the hands of the general public, transfer assets of doubtful value to the shell in exchange for newly issued shares, generate publicity inflating the prospects of the company and, as this produced market activity in the shares held by the public, the promoters would sell their shares at artificially inflated prices. In one case, a single company spun off more than 15 shells to the investing public, no filing was made with the Commission and investors were trading in these issues without the disclosure required by Federal law. Early in 1969, more than 50% of the new issues quoted in the National Daily Quotation Sheets were shells. By instituting a number of enforcement actions against shell promoters and developing new rules which would require brokers to know the company before

quoting new securities in the sheets, the "shell game" has been substantially slowed down.

Even though we have had a substantial impact in curtailing the improper use of inside information, we are still required to devote a significant part of our resources to monitoring the securities markets in order to detect the unfair use of inside information. The investing public cannot tolerate methods by which a select group of persons obtains tomorrow morning's financial results today.

The Commission also has been required recently to take action in a number of instances where corporations have not fully and accurately disclosed the results of their financial operations and condition. In the past few months Court action has been instituted against three well-known corporations, whose securities are traded on our major exchanges, for what we deem exaggeration of their financial performances.

In another recent case we have alleged that a corporation's employee pension funds were improperly used by the principals of the company to further their own personal interests.

A number of instances have recently come to the attention of the Commission in which brokerage firms, including member firms of national securities exchanges, have engaged in sales of substantial quantities of unregistered securities. In so doing they have failed to meet applicable legal standards of

conduct in determining whether sales of these securities would result in registration or anti-fraud violations of the federal securities laws. Participation by substantial firms may be a significant factor in the success of this unlawful activity. In addition to affording access to the marketplace, they tend to create an appearance of propriety and substance which may be otherwise almost totally lacking.

The Commission has authorized the institution of administrative proceedings against a number of firms that have participated in such activities. We will issue a release concerning the matter in the near future.

During the recent crisis in the brokerage industry, we brought many administrative proceedings and injunctive actions against brokerage firms that were not meeting Federal standards of operational or financial responsibility. In some cases, we in effect suspended final action while the appropriate self-regulatory agency work with the troubled firm in an effort to save it. In other cases, we were able to secure prompt and effective remedial action by the broker. And, unfortunately, in some cases we were left with no alternative but to institute proceedings to close the firm as a menace to its customers and to the securities industry. In all of the enforcement actions of this type, we engage in the most deliberate weighing of alternatives and their consequences, because of the widespread nature of the violations and the impact on the whole economy of troubles on Wall Street.

Finally, I would like to emphasize that our enforcement program commands respect in large part because the actions we bring are taken against the powerful and the obscure violators alike. There is one standard of justice for brokerage firms, whether they be members of the New York Stock Exchange or local sole-proprietorships. There is one standard of justice for corporate issuers of securities, whether they be world-wide "blue chip" corporations, or newly formed companies whose stock is traded over-the-counter. There is one standard of justice for the banks, the attorneys, the accountants and other members of the securities industry, whether they be prestigious or unknown. That is the way it has been. And that is the way we are going to keep it.