



**U. S. Securities and Exchange Commission**  
Washington, D. C. 20549 (202) 272-2650

**News  
Release**

DISCLOSURE AND INVESTOR  
CONFIDENCE -- THE  
UNITED STATES EXPERIENCE

A Paper Presented Before  
The Tenth Annual Conference of the  
Interamerican Conference of Securities  
Commissions and Similar Organizations

Cartagena, Colombia  
June 25, 1985

Charles C. Cox  
Commissioner  
Securities and Exchange Commission  
Washington, D. C.

---

The views expressed herein are those of Commissioner Cox and do not necessarily represent those of the Commission, other Commissioners, or the staff.

For over fifty years, the U.S. Securities and Exchange Commission has had a mandate to create a market in which confidence prevails over fear. However, the securities markets have changed considerably since the SEC was created in 1934, and one of the most notable changes is the comingling of foreign and United States issuers and traders. In a recent release, which I will discuss in depth later, the SEC noted that:

"[t]raditional notions of a world made up of separate and distinct domestic capital markets are being replaced by a global market for corporate securities. \* \* \*. In addition to [increasing amounts of] foreign offerings in the United States, there have been several recent multinational offerings. \* \* \*. [A]n international capital market, both in primary offerings and secondary trading, is developing at a rapid pace." 1/

Given these trends, it seems natural, therefore, that there should be interest by other countries not only in the United States experience, but also in maintaining confidence in an international market.

Securities regulation in the United States was founded on one basic principle, and our experience over the past fifty years has confirmed that principle: Full and fair disclosure of every aspect of securities transactions is one of the best ways to create an efficient market in which buyers and sellers can trade with confidence. In this context, I would like to examine the past and present United States experience, and speculate a bit about the future.

### History of the United States Experience

The United States securities regulatory system was born in the aftermath of the stock market crash of 1929 and the ensuing national and worldwide depression. The regulation that resulted was premised on full disclosure. Indeed, when proposing the first of the securities laws to Congress in 1933, President Roosevelt remarked that it "adds to the ancient rule of caveat emptor the further doctrine 'let the seller also beware.' It puts the burden of telling the whole truth on the seller." 2/

This initial securities law -- the Securities Act of 1933 3/ -- used disclosure as a method to return investor confidence to the primary market, that is, the initial sale of securities to the public. Soon thereafter -- in the Securities Exchange Act of 1934 4/ -- the full-disclosure policy was applied to the secondary market, that is, the subsequent trading of already-issued securities, and to brokers, dealers, and issuers and their officers, directors, and shareholders.

The system that has ultimately emerged promotes investor confidence in the United States securities markets in three ways:

- ° through full disclosure of material investment information to investors;
- ° through the maintenance of fair, open, and honest capital markets; and
- ° through fair but forceful and effective enforcement of disclosure obligations.

Obtaining and holding investor confidence in this manner -- through full disclosure -- makes good economic and political sense. Investors can be confident in an efficient market, and low-cost information, provided through full disclosure, is one component of market efficiency. Informed investors, seeking to maximize their own investment needs and objectives, will most efficiently allocate capital among numerous investment opportunities. And the competing judgments of informed buyers and sellers in a free and open market for already-issued securities will reflect the fairest values for those securities.

As I noted in the list above, an important part of this philosophy is enforcement of the disclosure obligations of issuers and traders. The SEC is not a "merit regulator," that is, it does not judge the "value" of any particular investment. Only when promoters would deceive or defraud the public or otherwise avoid full disclosure does the SEC substitute remedial measures for the rigors of the efficient market. Louis Brandeis, who later became a United States Supreme Court Justice, argued in favor of full disclosure "as a remedy for social and industrial diseases," adding that "sunlight is said to be the best of disinfectants; electric light the most efficient policeman." 5/ If disclosure obligations are fulfilled, then the efficient or nearly-efficient market I have just described can operate to value investments and allocate limited funds among them.

### The Present System of Disclosure in the United States

With that background, I will briefly describe this full-disclosure market as it operates today in the United States under the Securities Act of 1933 and the Securities Exchange Act of 1934.

The Securities Act of 1933 requires issuers to file a registration statement with the SEC prior to an initial public sale of their securities. This registration statement is a source of public information for prospective buyers, and is a foundation for civil liability if the information is false or misleading. The issuer is required to provide full audited

financial statements and discuss material aspects of its operations, including the company and its actual and intended business operations, its officers and directors, its financial status, and the transaction for which the securities are to be sold. 6/

Most of the information in the registration statement is included in a prospectus, which must be given to purchasers prior to or immediately following any sale. Only a document which meets the requirements of a prospectus may be used to offer or sell registered securities; this eliminates much of the effect of any potentially misleading sales literature. 7/

There are several forces which assure the correctness of information contained in the registration statement and prospectus. The SEC staff reviews most Securities Act registration statements filed, and offers specific comments to potential issuers. Although the staff ordinarily approves the registration statement before any sales are made, such approval is only an informal review of the information disclosed, and is not endorsement by the SEC of the securities offered, or of the correctness of the information in the registration statement. As I noted earlier, we are not in the "merit regulation" business. If the information is false or misleading, the issuer, its officers and directors, the underwriters, and any experts authorizing and furnishing information in the registration statement -- such as accountants or engineers -- may be liable to investors. 8/ Fraudulent statements or omissions generally are prohibited in the offer or sale of securities, whether with a registration statement or otherwise. 9/

These provisions of the Securities Act help maintain investor confidence in the ways I described earlier. Investors are presented full disclosure of material information, and are provided markets for initial raising of capital that are fair, open and honest. However, Securities Act disclosure is designed specifically to confront the peculiar circumstances inherent in the distribution of securities to the public and, in view of the occasional nature of such distributions, does not assure a reliable source of information for investors continually buying and selling outstanding securities. The disclosure obligations of the Securities Act apply to issuers when they offer new securities to the public, and they are obligated to update the information provided in connection with an offering only until that public offer is completed. Congress recognized less than a year after the Securities Act that further disclosures would be required to return investor confidence to United States markets.

The Securities Exchange Act of 1934 was the next step. Its primary goal is the regulation of secondary trading markets for previously-issued securities. It expands the role of disclosure in several important respects.

First, information similar to that required for first-time sales under the Securities Act must be filed with the SEC -- and thus publicly available -- on a continuous basis. This current information obligation falls essentially on all issuers with substantial secondary trading in their securities. 10/

Second, the Securities Exchange Act extends the full-disclosure policy to securities trading by corporate insiders. Provisions of the Act discourage insiders from profiting on inside information, and prevent management from perpetuating itself through misuse of voting proxies. Officers, directors and large shareholders must file stock ownership reports with the SEC, and their corporations can recover profits gained or losses avoided by these persons from trades in the corporation's securities within six-month periods -- so-called "short-swing" trading. 11/ General antifraud provisions preclude the use of misleading statements or omissions, both in the purchase or sale of securities and the solicitation of proxies. 12/ In addition, the SEC has set minimum disclosure guidelines for those who solicit shareholder proxies. 13/

Finally, the Securities Exchange Act carries this full disclosure philosophy to the brokers and dealers who trade the issuers' securities. They must file with the SEC and make publicly available certain operating and financial information, are required to operate with certain amounts of capital surplus, and are subject to certain fiduciary standards when dealing with customers. 14/ Among other obligations under the Securities Exchange Act, brokers and dealers must ensure that they have current information available about securities when they quote trading prices in those securities. 15/ In addition, brokers and dealers, like all other market participants, are prohibited from making fraudulent statements or omissions -- an obligation enforceable by the SEC as well as by those allegedly misled or defrauded. 16/

These provisions of the Securities Exchange Act, like the Securities Act, promote investor confidence in the ways I have described earlier. The Act expands the material investment information available to the market, ensures fair operation of the buying and selling operations, and provides statutory methods for individuals and the SEC to enforce these obligations. The Securities Exchange Act also relies on full disclosure in ensuring investor confidence by increasing publicity in certain areas. The "players" in the market -- officers, directors, large shareholders, brokers and dealers -- are vested with certain fiduciary responsibilities; the Act requires disclosure of facts which allow market participants to determine whether these fiduciary duties are being met. These "publicity" features of the Act encourage the voluntary maintenance of proper fiduciary standards by those in control both of the securities markets as well as the large corporate enterprises whose securities are traded on those markets.

I believe that over the past fifty years, these disclosure systems have evolved and become more sophisticated in response to market changes. The result, I submit, is self-evident -- investors virtually everywhere in the world have great confidence in the United States securities markets. However, the future will undoubtedly bring new challenges.

### The Future -- A System of International Disclosure?

Although I believe that the world's investors do have confidence in the United States markets, due in large part to our disclosure requirements, they have confidence in other markets as well. Other markets have different methods of regulation, and newer markets are beginning to develop still other regulatory schemes. The SEC recognizes the urgent need to consider the impact which differing regulatory systems may have on the development of fluid world markets. I would like to discuss three of our current initiatives in this area.

Internationalization of Disclosure. Earlier this year, the SEC requested commentary on proposals to unify disclosure obligations in public offerings of securities in the United States, Canada, and the United Kingdom. 17/ We are currently considering two possibilities for such unified disclosure:

- ° the "reciprocal" approach, where the disclosure requirements of the issuer's home country, subject perhaps to some minimum standards, would be acceptable for offerings in the other countries involved; and
- ° the "common prospectus" approach, where the countries involved would agree on common disclosure requirements, so that the same filings would be used by all issuers in these countries.

The request for comments noted that this is a relatively modest first step, limited in scope. Canada and the United Kingdom "use the United States' capital markets frequently and their disclosure requirements are more similar to the United States' requirements than those of other countries." 18/ However, it is an area in which there is worldwide interest in United States developments. For example, the Wall Street Journal recently concluded that the internationalization of accounting standards may be spurred more by market forces than by the actions of regulators. The Journal noted that "[a]s more large European firms seek to raise funds on world markets, especially in the U.S., they have had to upgrade their accounting practices and, in many cases, adopt U.S. accounting standards to attract investors and meet government filing requirements." 19/ It appears, therefore, that there is a demonstrated need to maintain investor confidence -- a need which the SEC is seeking to fill in examining international disclosure standards.

Internationalization of Trading. Our second initiative in the international area that I would like to discuss involves the secondary international markets. Just as the two major United States laws -- the Securities Act and the Securities Exchange Act -- focus respectively on the primary and secondary securities markets, so do the SEC's two major internationalization initiatives. Shortly after the release I just described, the SEC requested public comment on a number of issues raised by the internationalization of the securities trading markets. 20/ The SEC indicated that its concern is primarily with simultaneous international trading, and not with so-called "after hours" trading, which involves mostly professional and institutional investors. The SEC "believes that it is important for the United States and foreign securities industries, markets, and regulators to consider ways of ensuring that where a global marketplace does develop, it is fair, efficient, and accessible to investors." 21/ In the disclosure area, the release seeks comments on how to best consolidate reporting of trading prices and quotations in the worldwide market. Clearly, the more efficient this market, the more quickly it can impound all relevant information and facilitate full disclosure. Investors can surely trade with confidence in such a market. In this area, as well as in the primary markets as I discussed above, the SEC's interest in the trend toward internationalization parallels the development of these markets by themselves. It is important that the mechanism for ensuring investor confidence -- that is, full disclosure -- develops at the same pace.

Computerization. The third initiative I want to discuss is the technological changes which are accompanying the push of securities markets beyond national borders. The Electronic Data Gathering, Analysis and Retrieval System -- EDGAR for short -- was started by the SEC last year to improve the efficiency, accuracy and speed with which filings are made with the SEC and, in turn, the dissemination of such information to the markets. Information received through the system will be in a machine-readable format that can be quickly disseminated and analyzed by the financial community, and institutional and individual investors. This instantaneous dissemination is designed to facilitate and streamline entirely new processes for investment decisions and for capital formation. I believe systems such as EDGAR have the potential to increase United States and world market efficiency in unparalleled ways -- and more efficient disclosure, of course, leads in turn to greater investor confidence.

### Conclusion

I've made it clear by now that I'm a firm believer in the benefits of efficient markets -- investors may have the greatest confidence in them. Markets are efficient only if there is low cost information -- and full disclosure goes a long way toward providing that information. I believe that the history of the

United States experience with its securities markets shows that full disclosure breeds investor confidence, and I look forward with excitement to our efforts in building investor confidence in the new worldwide securities markets of the future.

ENDNOTES

- 1/ Securities Act Release No. 6568, 50 Fed. Reg. 9281, 9281-82 (Mar. 7, 1985).
- 2/ S. Rep. No. 47, 73d Cong., 1st Sess. 6-7 (1933); H.R. Rep. No. 85, 73d Cong., 1st Sess. 1-2 (1933).
- 3/ 15 U.S.C. 77a-77aa, hereinafter "Securities Act."
- 4/ 15 U.S.C. 78a-78jj, hereinafter "Securities Exchange Act."
- 5/ L. Brandeis, Other Peoples' Money and How the Bankers Use It (1914).
- 6/ See generally Securities Act §§ 5, 6, 11, 12 and 17, 15 U.S.C. 77e, 77f, 77k, 77l and 77q, and also Regulation S-K, 17 C.F.R. 229.1 et seq.
- 7/ See generally Securities Act § 10, 15 U.S.C. 77j, and Rules 138, 139 and 153, 17 C.F.R. 230.138, .139 and .153.
- 8/ Securities Act §§ 11 and 12(2), 15 U.S.C. 77k and 77l(2).
- 9/ Securities Act § 17(a), 15 U.S.C. 77q(a).
- 10/ Securities Exchange Act §§ 12(b), 12(g) and 15(d), 15 U.S.C. 78l(b), 78l(g) and 78o(d).
- 11/ Id. § 16, 15 U.S.C. 78p.
- 12/ Id. §§ 10(b), 14(a) and 14(e), 15 U.S.C. 78j(b), 78n(a) and 78n(e), and Rules 10b-5, 14a-9 and 14e-3, 17 C.F.R. 240.10b-5, .14a-9, and .14e-3.
- 13/ See Schedule 14A, 17 C.F.R. 240.14a-101.
- 14/ See generally Securities Exchange Act § 15, 15 U.S.C. 78o, and the Rules thereunder.
- 15/ Id. § 15(c)(2), 15 U.S.C. 78o(c)(2), and Rule 15c2-11, 17 C.F.R. 240.15c2-11.
- 16/ See supra text accompanying note 12. An action under § 10(b) may be brought either by the SEC or by private parties. See id. § 21(d), 15 U.S.C. 78u(d) (SEC); Kardon v. Nat'l Gypsum Co., 69 F. Supp. 512 (E.D. Pa. 1946) (private parties).

17/ See supra note 1.

18/ Id., 50 Fed. Reg. at 9281.

19/ Hemp, Where Boards and Governments Have Failed, The Market Could Internationalize Accounting, Wall St. J., May 8, 1985, at 34, col. 1.

20/ Securities Exchange Act Release No. 21958, 50 Fed. Reg. 16302 (Apr. 25, 1985).

21/ Id., 50 Fed. Reg. at 16305.