THE ROLE OF FINANCIAL PUBLIC RELATIONS

An Address By
Ray Garrett, Jr., Chairman
Securities and Exchange Commission

Presented before the
PUBLICITY CLUB of CHICAGO
March 13, 1974
Chicago, Illinois

I suppose there once must have been a time when the role of financial public relations officers was completely enjoyable and not terribly troublesome. Corporate earnings were up, new products were flooding the markets, investor participation in equity securities was brisk and companies generally had ready sources of capital available to use for corporate expansion. Time and the economy, however, have a way of changing things, and your roles are not exempt.

Today, the economy appears to be suffering from some malaise, and the securities industry definitely is, thus calling into question the capital-raising ability of the companies you serve and the securities industry we regulate. And, in these days of energy crisis, the fact that the companies you represent may turn a profit does not, of course, necessarily guarantee a return for you to the pleasantness and less trying days of by-gone eras. I can imagine, for example, the chagrin with which the financial public relations officials for our oil companies faced the rather dubious assignment of apologizing to the public for the profitable state in which these companies recently have found themselves.

Government regulation also has a way of breaking up the pleasant reveries of past glorious days. In those old days, corporate press releases and annual reports to shareholders were the principal means of disseminating corporate information to the public as well as to the corporation's own shareholders. Scant legal attention was then paid to most of these documents.

It was just ten years ago, however, that the Securities Exchange Act was amended to require the registration, under that Act, of the equity securities of companies that were not listed on any national securities exchange, if they were held by at least five hundred persons and the issuer had at least one million dollars in assets.

Prior to that time, the provisions of the Securities Exchange Act relating to the filing of periodic reports and proxy solicitations, as well as certain other matters, applied only to companies whose securities were listed with a national securities exchange. The '64 Amendments extended these provisions to virtually every company in the country that had any substantial public investor interest.

Since this expansion of our jurisdictional reach, we have been engaged in a steady expansion of corporate disclosure requirements, and the rules of the game, particularly in this era of expanding litigation under our general anti-fraud rule, Rule 10b-5, have also experienced a concomitant expansion. It might be said that we are still catching up with the significance of the enormous expansion of our federal laws as they relate to continuous disclosure. Why do we continue to place such emphasis on expanding corporate disclosure? Where are we heading?

One of the primary functions of our capital market system is to allocate capital in a fair and efficient manner. The continued availability of material corporate information is essential, in my view, to the refinement and maintenance of efficiency in our markets, an effort in which you play a major role. The underlying economic principle being that, in a free economy, capital will flow to where it will be the most profitable and, therefore, in the long run the most productive and useful, and that the decisions of many individual investors as to where capital will flow are better, overall and in the long run, than decisions made by any official body, however expert. It is not surprising, therefore, that, in his recent report to the Treasury Department, entitled "Public Policy for American Capital Markets," Professor Lorie reiterated the important need for a continual flow of corporate information for the

The 1964 Amendments that thus extended the Securities Exchange Act to apply to American industry at large, led Milton Cohen, a Chicago attorney who had been the Director of the Commission's Special Study of the Securities Markets in the early 1960's, in addition to his other great achievements, to write an article in the Harvard Law Review, exploring the significance of the changes that had been made and suggesting that the time had come to concentrate upon a continuous disclosure process and, incidentally, to take some of the pressure off the single event of the registration of a public offering of securities.

He pointed out, in a most compelling fashion, that we had been providing elaborate information and protection to persons who purchased issues that were registered for public sale under the '33 Act, while we were under-informing and under-protecting persons who participated in our ordinary trading markets, a rather severe indictment, in view of the fact that the latter investors were and are, by far, more numerous and more needing of protection. He also pointed out that, if the continuous disclosure system worked properly, Securities Act registration requirements could be met in large part by relying upon the regular disclosures made pursuant to the Securities Exchange Act and that the ordinary registration statement for the public distribution of securities could be a much simpler and less expensive document. Most of our thinking since then has been strongly influenced by these observations.

This integration of the disclosures in 1933 Act registration statements with 1934 Act reports has been manifested in new "short" registration forms, such as the S-16 and S-14, which permit '33 Act registration by incorporating '34 Act reports and proxy statements. This program has also greatly improved the disclosures made in 1934 Act reports. Annual reports required to be filed with us on our Form 10-K, which once served as a kind of adjunct to the annual report to shareholders, were amended in 1970 to expand the type of information required to be filed.

More recently, we have attempted to improve disclosures relating to financial statements -- principally, we have tried to make them understandable. The Commission has been moving to require financial statements that contain more information that will be useful to investors and their advisors.

Those of you who have responsibilities relating to stockholder relations in the furnishing of information to investors and publicly-owned companies, paid, I hope, particular attention to the Commission's recent release proposing to amend our rules to require that certain additional information be included in the annual reports companies subject to our proxy rules send to their shareholders.

Specifically, we have proposed that annual reports to shareholders contain information describing the general nature and scope of the issuer's business; disclosure of the contribution of a company's various lines of business to the company's sales and earnings; a five-year summary of earnings; information indicating the nature and scope of the liquidity and working capital requirements of the issuer; at a minimum the name and principal occupation or employment of each director and executive officer; the identification of the principal market in which the company's securities are traded and the high and low prices for each quarter over the most recent two years, together with information as to dividends paid and a statement of the company's dividend policy; and a statement that the company will send a copy of its annual report on Form 10-K to any securityholder on request.

In addition, we have proposed that financial information and data or financial highlights in the form of charts, graphs, figures and the like, do not present the results of operations or other financial information in a light either more or less favorable than do the financial statements included in the annual report to shareholders. We also would put an affirmative burden on the company, when it solicits proxies, to determine from the recordholders of its securities the number of beneficial owners of those securities and to provide sufficient copies of its annual report to shareholders as well as the other proxy materials to the recordholders on request, in order to permit the recordholders to provide copies to each beneficial owner. The company must also agree to pay the reasonable expenses incurred by the recordholder in transmitting these reports and other material.

Despite some reaction to the contrary, these proposals are not really very startling or revolutionary. At least, I imagine that a reasonably intelligent person looking at our financial laws and folkways for the first time, instead of being surprised at our proposals in this recent release, would be most curious as to why it took an agency, which frequently flaunts its devotion to disclosure, forty years to get here. It might be a little difficult to come up with a convincing explanation, but to those of us who have been living through the process for many years, we realize that the matter is deeply affected by limitations in our statutory authority, fears of liability on the part of corporate management, resentment and resistance to the government intruding in the flow of communication between corporate management and its shareholders, and some substantive disagreement on the merits of some of the specific matters proposed.