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SEMINAR: IRREGULAR PAYMENTS AND EFFORTS BEING MADE TO CONTROL THEM

Statement of

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The Administration's Views and
Status of U.S. Congressional Legislation

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You have invited me to talk to you about recent Congressional initiatives to combat overseas bribery and to discuss the Administration's position on proposed legislation in this area.

I'm not going to surprise you by telling you that the Administration takes the view that business is not to be secured on the basis of bribery. In one sense, that view reflects a moral judgment, the notion that that's just not right. But it also reflects, as Mr. Peterson emphasized, an economic judgment. Bribery distorts the efficient allocation of resources by interferring with market mechanisms. That basis for the Administration's view ultimately requires a coordinated international attack against competition by bribery. Thus, we are particularly pleased with the Chamber's vigorous efforts to develop a comprehensive and effective program of promoting ethical practices in commercial transactions.

The Administration's desire to be clear about the impropriety of bribery also reflects its hope for avoiding some of the unpleasant side effects which have resulted from the discovery and publication of improper conduct. The embarrassment resulting from some of these disclosures have created strains in our foreign relations and disturbed the international investment climate.

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Let me just take a minute to review with you where we've been before we take a look at where we're going in terms of new legislation. I need not rehearse for you in detail the rather vigorous governmental attack on the problem of corrupting payments. As an alumnus of the SEC, I can say with some pride that the SEC has been in the forefront of that effort. Indeed, I suppose there was a time not so long ago, when hardly a day passed without the newspapers announcing another SEC-elicited disclosure of past questionable payments. I think the count is roughly 400 cases of questionable foreign payments which have been disclosed.

The Commission's efforts were mounted within the framework of existing law which focused on disclosure of material events. In many cases, the failure properly to reflect in the company's books the payment of money to foreign government officials undermined the soundness of the company's books and records. As you know, accurate books and records are the foundation of reliable financial statements, and reliable financial statements are the key to the entire disclosure system. In other cases, the transactions supported by corrupting payments were material to the company and the chances that the transactions could be undone had a substantial impact on the

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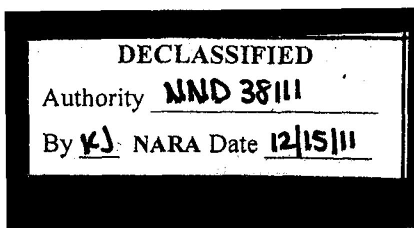
riskiness of the public's investment in the company. A third facet of the Commission's cases involved the fact that participation by senior management in illegal activities would be a material factor in investor evaluation of the quality of management.

Perhaps the most noteworthy aspect of the SEC enforcement program relates to its innovative techniques for promoting greater self-regulation by nonmanagement directors aided by professionals such as lawyers and accountants. Increasing the responsibility of outside directors was seen as a key step toward the future prevention of improper practices.

The SEC, of course, hasn't been alone in pursuing antibribery initiatives. In 1976, the Internal Revenue Service began asking taxpayers those famous eleven questions which were designed to ferret out information about the existence of slush funds used for payments which had been or might have been improperly deducted as corporate expenditures. As you know, under the Internal Revenue Code such payments are not deductible if they were illegal where paid, or even if legal where paid, but illegal under U.S. law had U.S. law been applicable to the payment. To date, the eleven questions have been asked in approximately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900 large case examinations and indications of slush funds or illegal activity have been found in over 330 large cases. Most of these cases are still under active consideration, and over 70 criminal investigations have been started.

The Tax Reform Act of 1976 contains further tax penalties for improper payments. It provides that a DISC or a controlled foreign corporation cannot deduct an illegal bribe or kickback paid to a foreign official, nor can it defer taxes on the amount represented by the bribe or kickback.

The Justice Department has also been active in uncovering instances of bribery using such diverse authority as the Bank Secrecy Act (which governs transportation of cash in and out of the United States) and the mail fraud laws. I understand that the Justice Department has reviewed the foreign activities of approximately 50 corporations and that this review has resulted in the opening of active criminal investigations of 8 corporations. Several of those investigations, I understand, are in the grand jury stage.

The reason for spelling out this history is to ask whether, in the light of those past activities and others which I haven't had a chance to talk to you about, there

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is a need for additional legislation. Or is what we have sufficient? Before turning to the answer to that question, let me tell you what bills are presently in the Congressional hopper.

1. S. 305 has passed the Senate by a voice vote. I will return to S. 305 in a moment.

2. H.R. 3815 has been marked up by the Consumer Protection and Finance Subcommittee of the House Committee on Interstate and Foreign Commerce.

3. The Transportation and Commerce Subcommittee of the House Interstate and Foreign Commerce Committee is scheduling hearings on a quite different bill, H.R. 7543. Those hearings were scheduled to begin yesterday, but now they have been rescheduled for the 21st of July.

S. 305, introduced by Senator Proxmire, makes criminal the payment of anything of value to a foreign official or a foreign political party or candidate for office for the purpose of having such a person use his influence, or fail to perform his official functions, to help in obtaining or retaining business or to influence legislation. That prohibition is quite broad. S. 305 also prohibits payment to any person while knowing or having reason to know that he will make corrupting payment to a foreign government

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official. Of course, the corrupting transaction must be made in connection with the use of the U.S. mails or other means of interstate commerce. The way the prohibition is phrased suggests it does not cover facilitating payments, which include such payments as money given to a government official to get normally available policy protection, or to expedite matters through Customs. In other words, the bill excludes payments made to get an official to do more quickly what he ought to be doing anyway. Also, the words of the statute appear to leave room to argue that extortion cases are not covered.

To whom do these prohibitions apply? First, they apply to issuers of securities registered under the Securities Exchange Act (that's under 12(g) of the Exchange Act) or to companies which are required to file reports under section 15(d) because they have made a distribution in the United States. The latter provision would include foreign companies. The prohibition also governs officers, directors, employees or shareholders acting on behalf of one of the issuers I have described.

A second set of persons against whom the prohibitions are directed is domestic concerns. Domestic concern is defined as a U.S. citizen or national, an entity organized

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under U.S. law, or a foreign entity which is controlled by U.S. individuals and which has its principal place of business in the United States. That definition, as you will readily perceive, excludes most foreign subsidiaries of U.S. companies.

How does H.R. 3815 differ from S. 305? It takes a very similar approach in making corrupting payments to foreign government officials and political parties a criminal violation of U.S. law. It also has an interesting provision forbidding any issuer or domestic concern from paying directly or indirectly any fine levied upon any natural person for violating the law. It would also catch foreign entities controlled by U.S. individuals, even though their principal place of business is not in the United States. In that sense, it has a potentially broader reach than the Senate bill.

The Administration supports the notion that bribery of foreign government officials should be treated as a criminal offense under U.S. law. Making such corrupting payments a crime underscores the governmental disapproval of such activity by persons over whom we have jurisdiction. Moreover, our taking strong action against bribery of foreign officials by making such acts unlawful should facilitate efforts to obtain international action against bribery.

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Nevertheless, we do have some problems with the proposed legislation. One, we think the bill goes too far in subjecting to our criminal law truly foreign companies simply because they use our capital markets and thus must file reports under section 15(d) of the Exchange Act.

We are also concerned about the provision in both the House and the Senate bills making bribery a violation of the securities law when done by an issuer of a class of securities which are registered under the Exchange Act. In other words, both bills make bribery of a foreign official a criminal violation under the securities law. But bribery of U.S. officials by a domestic company and bribery of foreign officials by companies not registered under the Exchange Act are criminal acts under Title 18 of the U.S. Code, not under the securities laws. At the very least, that arrangement is untidy. Why should there be such a disparity of treatment? Remember that even without any new legislation, the SEC would, in all cases, have the right to pursue investigations in furtherance of disclosure requirements of the Federal securities laws -- and that covers a very broad area. Even under the approach embodied in the bills, for all cases which are going to be criminally prosecuted, prosecutorial discretion rests with the U.S. Attorney.

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In creating a criminal offense for bribery under the securities laws, the bills explicitly give the SEC a new substantive regulatory mandate that goes beyond its traditional focus on disclosure. Some would argue that all it does is confirm the SEC's efforts to impose standards of conduct in some of its past pursuits of foreign payments. But I think one must take a little broader view and tie together the jurisdiction given to the SEC under the bills and other steps the SEC is taking to impose substantive regulations on corporations. When that is done, we begin to see the articulation of a new SEC mission as a direct regulator of corporate conduct. Perhaps the Commission should be given this new direction. But that legislative judgment should be made directly and only after full consideration of all the relevant policy considerations.

Now, let me turn to a bill I haven't talked about, the one they haven't had hearings on yet -- H.R. 7543, which was introduced by Congressmen Rooney and Skubitz. That bill essentially resurrects many of the aspects of the Richardson Task Force approach to the bribery problem. It does not provide criminal penalties for bribery, but rather, under threat of civil and criminal penalties, requires broad disclosures of payments made to foreign

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public officials. It also provides for treble damages to be recoverable by companies which have been injured as a consequence of improper payments made by competitors. It also contemplates a special office being created to administer those disclosure provisions. Since the Administration is firmly committed to supporting a criminalization approach to bribery as embodied in S. 305 and H.R. 3815, there seems little possibility of our supporting a reporting and disclosure approach at this time.

There is one other aspect of S. 305 which I would just like to take two minutes to talk to you about. It has certain substantive provisions relating to accounting controls and records. Those provisions mandate the keeping of corporate books and records which accurately and fairly reflect the transactions and dispositions of the assets of the issuer and require the issuer to maintain and devise an adequate system of internal corporate controls. The bill makes it unlawful knowingly to falsify or cause to be falsified any book, record or account. These provisions reflect the Commission's experience that improper payments were, in many cases, made out of funds kept in off-book accounts and out of sight of top-level executives and outside directors. The provisions of S. 305

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which I've described parallel, in most instances, proposed SEC rules under existing provisions of the Securities Exchange Act. Those rules were promulgated in March of this year. Public comment was invited and much comment was received. I don't believe the Commission has yet fully analyzed these comments. It has certainly not yet reported to the public on them. The Administration is concerned that if those accounting provisions of S. 305 are enacted they will freeze into a legislative mold directives which otherwise would be amenable to the more flexible rule-making procedure.