Remarks of SEC Chairman William H. Donaldson
Caux Round Table
November 30, 2004

Let me start by thanking the Caux Round Table for giving me this much appreciated honor and the opportunity to speak this evening. The Round Table has done, and continues to do, important and valuable work – in the United States and throughout the world – helping to advance ethical business practices and a moral capitalism. It is an honor and a pleasure to be here.

I also want to thank John Whitehead for his generous words. Through his career in business and government John has come to embody the ideals at the core of the Caux Principles for Business. He has been a close friend for many years, and as many of you know he has had a long and distinguished career as the senior partner at Goldman, Sachs and as Deputy Secretary of State. Today, New York and the nation are fortunate to have him leading the Lower Manhattan Development Corporation, which has been helping to rebuild the area around the World Trade Center following the September 11th terrorist attacks. He has also served as a director of many non-profit organizations and business corporations, including Pillsbury here in Minneapolis.

I also want to acknowledge what an additional honor it is to have received an award in memory of the ideals and aspirations of Kenneth Dayton. I was fortunate to have known Ken during much of his business career. He was a man I greatly admired. That admiration has only grown as I look back on his legacy. His philosophy is embedded in the Minnesota Principles, and he helped to nurture this state's progressive business tradition. He practiced what he preached. And of course all of you are aware of the Dayton Corporation's historic leadership role in the area of enlightened corporate philanthropy.

Ken was clearly a man ahead of his times, on many different fronts. His business foresight was brought home to me recently when I reread an illuminating article he wrote for Harvard Business Review more than 20 years ago. The article spelled out his philosophy on corporate governance, and how he applied it at Dayton Hudson. His prescriptions on a range of subjects -- such as the importance of a strong board of directors, and the proper role for the board -- have more than stood the test of time. We are all indebted to him for his pioneering work.

Ken had the good fortune to be surrounded by other business leaders in this state who shared his commitment to maintaining a sound and ethical business sector. I speak with some personal history on this, as I've been privileged during my career to have been long associated with the Minnesota business community. One of the first major clients to do business with the investment bank I helped to launch in 1959 was IDS – and I take special pleasure to be staying in the IDS Center tonight! I also served on the board of Honeywell for 15 years, and I am familiar with many of the other great companies that have, over time, been headquartered in this state – companies like Medtronic, Pillsbury, General Mills, 3M, Cargill, and, of course, the old Dayton Corporation, now Target. Chalk me up as a fan of this state's businesses, and your business practices.

It's not an accident, of course, that Minnesota has developed a business sector defined by a strong ethical compass. For this is the home of the Minnesota Principles, which were drafted by business leaders more than 10 years ago to foster fairness and integrity in the business relationships that might define the emerging global marketplace. These principles helped to inspire the valuable Caux Round Table Principles for Business, which is recognized as one of the most comprehensive statements of responsible business practices ever formulated by business leaders. The principles have energized thinking about ethical business practices in not just the United States, but throughout the world, with special emphasis in Europe and Japan. By helping to create a framework for global business practices, the Caux Round Table has set the stage for adding a qualitative dimension to an increased global prosperity that we all aspire to in the years ahead.

While the Caux Round Table has a broad mandate of working to advance fundamental business concepts – improved corporate ethics and a moral capitalism – the Securities and Exchange Commission has a more narrowly defined but equally worthwhile mandate: enforcing America's securities laws and strengthening investor protections. The enforcement of these laws and regulations provides the basic framework – a starting point, if you will, which encourages positive enhancement through ethical and moral behavior.

It is within this context, given the limited time we have tonight, that I would like to provide a brief overview of the Commission's work over the past two years. Indeed, this has been the most active period in the agency's 70-year history – reminiscent of the years following the market turmoil of 1929-32, which was a period of corporate and personal malfeasance that gave rise to the securities acts of 1933 and '34, and the creation of the SEC itself. Indeed, the Sarbanes-Oxley Act of 2002, which followed the disturbing improprieties of the late 1990s, coupled with our rulemaking and enforcement actions, have begun to correct many if not most abuses found in our markets and the corporate world. But before I go any further, let me issue the obligatory standard disclaimer that the views I express here are my own and do not necessarily represent those of the Commission or its staff.

A high priority for the United States, for the SEC, and for me as SEC Chairman is helping to foster the growth of capital markets. I speak from the perspective of having labored in and around financial markets and the corporate world for much of my professional life. These experiences have shown me, time and again, the multiple benefits that flow from dynamic markets and enlightened corporate governance. These benefits help to reduce the cost of capital and provide a more stable platform for sound long-term economic growth. And these conditions, in turn, spark prosperity and create opportunities for investors to achieve higher returns.

But these benefits cannot be realized if markets are dysfunctional or corporate governance is distrusted. As we all know the ebullient markets of the 1990s eventually came to an end, and this era was followed by revelations of widespread malfeasance at a number of leading companies, coupled with a recognition that ethical standards had eroded throughout the business sector. As noted, it was a period not unlike that following the stock market crash in 1929, though in the more recent era a much higher number of investors and percentage of households had direct or indirect ownership of equities.

The stock market collapse, with three consecutive years of decline in the Dow, coupled with the corporate misbehavior, has led to a prolonged decline in investor confidence. As a principal regulator here in the U.S., we at the Commission have been well aware of the need for action to calm these fears. But this is much easier said than done. The malfeasance has continued, and our work to raise standards has presented a conundrum that Alexis deTocqueville wrote of nearly 150 years ago: "Every abuse that is . . . eliminated seems to highlight those that remain, and makes them feel more biting." He added that, "the evil has decreased, it is true, but the sensitivity to it is greater."

While Congress and the President enacted Sarbanes-Oxley to improve financial reporting and prohibit a number of business practices that some had come to abuse, the Commission has pursued a sweeping reform agenda. Let me mention a few of our actions.

By mid-2003 we completed – under an extremely tight deadline – the extensive rulemaking related to Sarbanes-Oxley. Critically important has been nurturing the growth of the Public Company Accounting Oversight Board, mandated by the new law to restore integrity to the auditing and accounting profession.

Over the past two fiscal years, our Enforcement division has intensified its aggressive pursuit of those who have violated our securities laws and the public trust. During this period, the division has filed more than 1300 enforcement actions and obtained orders for penalties and disgorgements totaling nearly $5 billion.

We have also made real progress on the vital issue of self-regulatory organizations, most particularly SRO governance. The Commission has fostered and approved a proposal by the New York Stock Exchange to implement reforms, such as its own organizational structure, aimed at insulating the regulatory functions from conflict with the business functions.

We also believe that SROs play a critical role as standard setters for issuing companies, operators of trading markets, and front-line regulators of securities firms. We must insist on holding them to higher corporate governance standards as well. The Commission recently voted to propose new rules, and amend existing rules, to improve the governance and financial transparency of all U.S. self-regulatory organizations.

We are also reviewing the structure of our national market system, and the Commission has put forward ideas on how to modernize our markets. Proposed regulation NMS encompasses a broad set of initiatives designed to improve the regulatory structure of U.S. equity markets. While we are still reviewing a number of proposed reforms we hope to bring forth our new rules shortly.

Another area we have focused on is the problems facing the mutual fund industry. The complicity of elements within the industry to condone certain unethical practices and to collude to engage in outright illegal behavior has been an unwelcome shock to the system.

In addition to unprecedented enforcement activity targeted at mutual funds, the Commission has approved 9 of 12 major new mutual fund reform initiatives. Taken together these initiatives seek to strengthen the governance structure of mutual funds, address conflicts of interest, enhance disclosure and transparency, and foster an atmosphere of high ethical standards and compliance.

In an attempt to reduce the incidence of ethical breakdowns at mutual funds, the Commission has approved a rule that requires them to maintain compliance policies and procedures, as well as a chief compliance officer. A critical new Commission rule requires funds relying on certain exemptive rules to have an independent chairman and 75 percent independent board members, creating a structure for implementation of both the letter and the spirit of our new regulations. A third significant initiative that will help to foster an ethical, compliance-oriented atmosphere is the new requirement that all registered investment advisers, including advisers to mutual funds, adopt a code of ethics. The code of ethics must set forth standards of conduct for advisory personnel and address conflicts such as those that arise from personal trading by advisory personnel.

The Commission has also moved to bring greater scrutiny to so-called hedge funds. The hedge fund adviser registration rules, which the Commission adopted late last month, will afford us greater insight into the activities of hedge fund advisers, at a time when hedge funds are growing dramatically in size and influence in the securities markets.

As important as these initiatives are, perhaps the most important – and most lasting – may be the internal reforms we have instituted at the SEC itself. For starters, we have brought in more people – 1,100 additional accountants, lawyers, economists since December 2002. As we have brought in new people, we have worked to improve communications across the lines of our operating divisions and offices, to protect against any "silo" mentality from infecting the agency.

We have also created an infrastructure at the Commission around the concept of risk assessment. We are seeking to create an enhanced oversight regime that will equip the Commission to better anticipate, find, and mitigate financial risk, potential fraud, and malfeasance. The effort is designed around a new Office of Risk Assessment, which brings together professionals experienced in seeking out potential areas of concern, and helps us to concentrate our resources and investigations to the areas that pose the biggest potential threats to our markets. We want our efforts and oversight to be more anticipatory and preventative in nature – to look over the hills and around the corners of the securities markets in ways that will help us deter and detect fraud, and ameliorate damage when it occurs.

Each of these initiatives represents progress, and together they are helping to restore faith in the fairness of our markets. But there is, of course, still more work to be done.

Ethics in Business

Let me turn now to ethics and integrity in the business world. I note at the outset that after many years in and around American business, I believe the overwhelming majority of business leaders and managers are honest, and dedicated to meeting the needs of their clients and customers. But as all of you know, there are some individuals who have lost sight of their basic responsibilities – engaging in conduct that is well outside the lines of what is acceptable. In so doing, they have violated not only securities laws but in many cases an ethical code that underlies the rules.

The Commission has pursued enforcement actions against these individuals, and we have also pursued new rules that affirm the importance of compliance and ethics in the workplace. But our rules alone won't be enough. Indeed, we know from the course of history that human nature will push aggressive managers and organizations to continue to test new laws. Some managers will pursue questionable activity right up to technical conformity with the letter of the law, and some will step over the red line either directly or with crafty schemes and modern financial technology that facilitates deception.

What's really needed is a change in mindset – one that fosters not only a culture of compliance but also a company-wide environment that fosters ethical behavior and decision-making. Creating that culture means developing good policies and procedures, from the board room to the assembly line. It is critical, for example, for the corporation to be entrusted to the leadership of a Board and the chief executive the Board selects – to a leadership team that demands an approach that stays well short of pushing "up to the line."

These objectives won't be realized by having each company simply adopt a "politically correct" written code of ethics. Companies and managers and employees, from top to bottom, must embrace a spirit of integrity that goes well beyond simple adherence to the letter of the law. A moral compass should guide hiring decisions, operating practices, and internal policies and procedures regarding the questionable practices of years past.

As we all know, much of American business is defined by its dynamism and frequent change – new products, new systems, and vigorous competition. In this climate, business practices will frequently outpace any government regulator's ability to develop specific rules governing these practices, and they will further outpace any lawyer's ability to provide conclusive guidance by interpreting existing rules.

This is where having a culture of doing what is right – in the absence of specific rules and even in the face of your competitors' choosing a different path – is vital. This is where the courage and commitment of the firm's leaders is needed to question whether a particular firm practice – no matter what the lawyers say – is truly ethical or is truly in the best interests of client and customers. This culture can't be limited to the senior management level, can't be limited to the compliance department, and can't be limited to the clever wording of a corporate mission statement. It must be shared by each and every employee.

What I'm talking about is creating a renewed culture of compliance in American business. Every employee can play a central role in that renewal. At bottom, of course, every public company must maintain a state-of-the-art compliance department. But sound ethics goes beyond compliance. Let me suggest a few thoughts that would characterize the hoped-for DNA of the corporation in years ahead.

Attention must be focused on not just compliance, but also on the identification of potential but not-yet-developed conflicts of interest within the firm – where new business relationships or revenue streams could create conflicts with the best interests of the firm's customers. The heads of business units, including the firm's senior management, must be made aware of potential conflicts, and understand why it is important for the firm to manage these potential conflicts.

The ethical corporation must help employees of the firm understand their normal and in certain cases fiduciary responsibilities to customers, and ensure that they understand what those responsibilities mean – that customers always come before the profit and loss statement and not the other way around.

The DNA of an ethical corporation must encourage its employees to learn from their mistakes. If there is a breach in ethics or compliance it is imperative to figure out what went wrong and how it can be prevented from happening again.

Compliance and ethics should also be integrated into discussions about new products or new business ventures. Such a process will help to immediately address the risks those new products or business lines may present.

There should be a timetable set for policies and procedures regarding ethics and compliance to be evaluated, modified, and updated – with the goal of adapting compliance to the rapid changes in the environment in which the business operates.
And the most important element of an ethical corporation's DNA is for the leadership to set a personal example, regardless of place in the business. When a decision is made, no matter how large or small, at every level of activity, and no matter who is in the room or when the decision is made, everyone is obligated to check the internal compass as to whether the proposed decision is the right thing to do.

The investment of time and effort to establish this renewed culture of compliance is not without costs. But I believe it will pay long-term dividends, as it will enhance integrity within companies, and thus inspire confidence among customers and investors.

Only with the widespread inculcation of these values will our markets resume their rightful place as an engine of prosperity in the United States and throughout the world. I do believe the pendulum is swinging in the right direction, but to paraphrase Thomas Jefferson, the price of prosperity is eternal vigilance – by regulators, by corporate leaders, and by investors – of our constantly-changing markets.

The Caux Roundtable is helping to provide this vigilance, and I urge you to continue using your bully pulpit to advocate for good governance, sound ethics, and moral capitalism.

Thank you again for giving me the opportunity to speak. I would be happy to take your questions or hear your comments.