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THE SEC'S BIG CHALLENGE

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LAST WEEK PRESIDENT BUSH MADE ONE OF THE MOST IMPORTANT ENVIRONMENTAL DECISIONS OF HIS PRESIDENCY: HE CHOSE HARVEY L. PITT TO BE CHAIRMAN OF THE SECURITIES AND EXCHANGE COMMISSION. FEW PEOPLE CONSIDER THE SEC A LOCUS OF ENVIRONMENTAL POLICY, BUT THAT IS A MISTAKE.

The SEC was created in 1933 in a world in which millions of Americans had lost money in stocks and needed protection. Today it is one of the most important regulatory bodies in the country. Before the Great Depression, most investors were against government regulation of stock markets, but as it turned out, by protecting investors and ensuring full transparency and disclosure, the SEC has helped US markets become one of the most efficient and robust in the world. Economists never tire of telling us that markets are effective mechanisms for allocating scarce resources. But what they often leave unspoken is that markets can play this role only if there is transparency and widespread access to trustworthy information. Transparency and information make it possible for investors to put their money confidently in a company they have never seen managed by people they have never met. Without this access to information, without the safeguards and protection provided by a strong SEC, US stock markets could not function as they do.

Unfortunately, in at least one arena - the environment - this principle has not been upheld. Studies have shown that companies that face environmental and social risks, that know they face these risks, and that know they could translate into financial losses seldom disclose these risks in their reports to the SEC. Such lack of transparency is not only bad for investors, it is illegal. SEC regulations require that all companies produce management discussion and analysis reports on issues where a trend, demand, commitment, event, or uncertainty is both known to management and reasonably likely to have material effect on a company's finances.

Despite this, a study produced by the World Resources Institute found that various pulp and paper companies faced serious financial risks as a result of noncompliance with environmental regulations - risks in some cases worth as much as 10 percent of the company's market capitalization. These companies knew about these risks and yet failed to mention them in reports filed with the SEC. In an ideal world, the SEC would be monitoring this situation and enforcing its own rules. It would be requiring companies to report all important risks and liabilities, including environmental ones. And yet the study found that of more than 5,000 enforcement actions taken by the SEC in the last 25 years, only three were related to lack of disclosure of environmental risks and liabilities.

In a particularly ridiculous case, media giant Viacom was identified in 1997 as potentially responsible at dozens of contaminated Superfund sites. In statements that year, the company said it did not believe that these environmental liabilities would have an adverse effect on its operations, financial positions, or cash flow. And yet publicly available information suggested a total potential liability in excess of \$300 million, more than twice the company's profits in 1995. How much more material can a liability get? And yet this grievous lack of disclosure, with serious potential ramifications for investors in Viacom, would never have come to light if it hadn't been brought to the SEC's attention by the environmental group Friends of the Earth.

In a world where nearly 60 percent of Americans are invested in stocks and where it seems the entire economy depends on the properly tuned motor of capital markets, the role of the SEC takes on a new dimension: It becomes the FBI of finance, protector of the small investor.

If Bush is interested in the environment or, just as important, if he is interested in the proper functioning of US stock markets, he will ensure that Pitt understands the value of enforcing transparency and disclosure in securities markets. Transparency on environmental liabilities would do more for the environment - and for the world's capital markets – than a courtroom full of environmental laws and regulations.