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# A SENSE OF CONFIDENCE, DIRECTION AND MOVEMENT

An Address By

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A SENSE OF CONFIDENCE, DIRECTION AND MOVEMENT

It is a great privilege for me to have this chance to address this annual meeting of the Investment Bankers Association. I consider this a particularly opportune moment to review what your industry has accomplished in applying the lessons and overcoming the deficiencies revealed by the difficulties of 1969-70 and in establishing the basis for that renewal of public confidence which is so essential to meeting the challenges which confront you in 1972 and beyond.

You must have the confidence of the individual investor to do the job for which the economy and the nation counts on you. At the outset, let me express my own conviction that you have taken or are in the course of taking the steps which merit and command that confidence.

There are two signposts that define the challenge which confronts your industry. The first points up the degree to which American corporations will need unprecedented amounts of new equity capital for the balance of this decade. Our corporations have been meeting capital outlays by increasing their balance sheet ratios of debt to equity.

Reduced liquidity together with rising levels of interest costs and fixed commitments call for a higher proportion of net new equity capital. We were raising $3 to $4 billion in the closing years of the last decade. We will have to be raising from $10 to $15 billion a year for most of this decade.

The second signpost points to the degree to which the individual investor will have to participate in the equity markets if you are to meet these needs. Annualizing the first nine months' figures of this year, we are currently raising new capital at the rate of $13 billion a year. This year $10 billion will come into the market from pension plans -- private and public. Pension funds have been providing increasing proportions of new money all through the sixties. Growth in pension fund assets will level off because most of these plans, started during and shortly after World War II, are maturing and require increasing payments to beneficiaries. But half of the national work force is not covered by any pension plan at all. In addition, many people want to supplement their company pensions. Millions in business and professional activity have to provide their own retirement security. It is the trust and confidence of these millions which must be merited and won if our economy is to meet the needs of the nation.

That's why it is urgent to move with dispatch to resolve uncertainties and create a sense of direction and movement in improving the structure and efficiency and the performance of our capital markets.

That is why the small investor must have the continuing assurance that he is getting the same quality of information about the progress and performance of public companies at the same time as the company insider and the large investor.

That is why our markets must be structured to give all investors access to the same disclosure of prices, volumes and quotes and to the best available buying and selling opportunities.

I want to review with you what has already been done, what is under way and what we can hope for in the months ahead.

At the end of last year, Congress, through the Securities Investor Protection Act, provided investors with assurance that cash and securities they left with brokerage firms would be protected, similar to that of insured bank deposits, to the extent of $50,000 with the coverage for the cash portion of any loss not to exceed $20,000.

The investing public has not been left to rely only on this protection. Brokerage firms have been required to maintain more adequate, more liquid and more permanent capital, and to keep closer and more frequent checks on the securities they hold for customers, for other brokers and for themselves. New rules have been formulated, and have been published for comment, to require the separation of a customer's funds from his broker's business and to restrict the use of customers' funds to supporting customer obligations, principally loans to customers secured as required by Federal Reserve Board margin rules. These rules would also require that a customer's securities be segregated for his account or, if such segregation is not accomplished promptly, be protected by a cash reserve. Another new rule will give customers quarterly reports of the financial condition of any brokerage firm which handles their cash and securities. Additional rules will provide greater assurance that new entrants into the brokerage business are adequately capitalized at the outset and conservatively operated (at an 8 to 1 capital ratio) during their first year. In addition, they will be required to submit an effective operational plan and their operation will be inspected at an early stage. These steps taken together represent a significant improvement in the standard of care and attention which investors will get from their brokers. In the past, many brokers have met and exceeded this standard; now all will be required to meet it. It will entail some added burdens but as long as customer service and protection is maintained any of these new requirements can be changed and adapted to meet operational requirements. I strongly believe that these new standards will generate increments in customer confidence far exceeding in value the burdens of meeting them.

Major progress is being made in reducing the cost and disruption arising from the stupendous amount of paperwork surrounding the transfer of securities and the settlement process. Transfer agents are effectuating transfers whenever possible with jumbo certificates in order to avoid the multiplicity of smaller denomination stock certificates. Depositories for stock certificates have been expanding the number of securities eligible for deposit; in addition, new participants such as banks and mutual funds are making use of these depositories. New clearing facilities for over-the-counter securities involving modernized methods of clearance and settlement are now being established on a nationwide basis. Back office, odd-lot and round-lot trading are all being automated. As a percentage of trading activity, certain large New York transfer agents have reported reductions in transfer activity of from 25 to 30 percent. All this represents major progress. But more is needed. I believe that automated trading can be carried to automated clearing and settlement. During 1972, we can and must establish a course which will take us in a few years to a nationwide system of securities transfer and payment. When that course is established and set, you will get another big infusion of public confidence.

In short, we are well on our way towards safeguarding the funds and securities entrusted by customers to their brokers. We have taken important initial steps to provide operational and system efficiencies which can yield savings and better service to investors. Let me now review why investors from all over the world have special confidence in the information and judgment available to them about the performance of companies and the values established in our markets.

Nowhere in the world is more information available about more companies. Quarterly financial data must be filed by almost 10,000 corporations. You know, perhaps too well, the factual information which is made available in the registration process. Going beyond the registration of new offerings, this summer the Commission adopted a rule which assures that no previously offered shares, registered or not, will be quoted by a broker-dealer in any quotation medium unless he has certain minimum information concerning the issuer and the security either in the form of a current registration statement or somewhat comparable basic information.

The registration of new offerings is showing a marked increase, 884 during the July-September quarter compared to 562 in the same period a year ago. I can report that we're processing them faster in large part by putting more responsibility on the issuer, the underwriter and their counsel.

Over the last 6 months our percentage of unreviewed registration statements as compared to backlog has been brought down from 19% to 12%. What's even more important, however, is the time lapsing between an original filing and the issuance of staff initial comments. At present this time lag has been cut down to 17 days for repeat companies and to 50 days for first-time filings.

I'm dedicated to reducing time in registration, particularly between the filing date and the issuance of initial comments. Our staff presently has a variety of review procedures such as deferred review and cursory review, as well as our customary review. We intend to codify and soon to announce officially an additional procedure--summary review--with which we have been experimenting for some time. This procedure, a variant of our cursory review, entails notification to the company that limited processing has been done and the registrant will get only the comments resulting from this review. We request as supplementary information letters from the chief executive officer, the accountants and managing underwriter that they are aware of their statutory responsibilities and that staff review has been limited. Upon receipt of such letters in satisfactory form the registration statement is declared effective. We also are considering more effective use of transmittal letters covering the initial filing and of cover letters accompanying amendments to help speed up this process. While this is but one step that we will be taking--there will be others. I'm not going to be satisfied until we curtail significantly the time in registration and you can be assured that we intend to do so.

When we consider the need for new equity money in our economy, the area of new ventures is a particularly significant and critical one. New needs constantly emerge and innovative businessmen develop new ways to meet them. Scientists develop new technologies and engineers adapt them to practical uses. Today, our balance of payments and ability to compete in world markets depends heavily on developing and financing new high technology and high skill products. At the same time, in 1962 and 1968 we saw too vividly how badly new ventures, financed with unsophisticated public money and converted into hot issues, can weaken public confidence. This time, let's generate the new money for important new technologies and other ventures without sowing as many seeds of disillusionment. There will be failures but I believe that by doing a better job of getting the economic and technological realities on the table we can reduce disillusionment and maintain confidence. The investment banking fraternity and the Commission together can set higher standards for new businesses seeking public funds. We have announced a public fact finding investigatory proceeding concerning "hot issues" in our securities markets. This inquiry will reexamine the disclosure policies for first-time filings as well as the distribution process and after-market trading activity. Our objective is to promote more knowledgeable, more sophisticated and more useful investment in businesses going public for the first time.

The investigation is now underway and is being directed and coordinated by our Division of Corporation Finance with material assistance to be provided by our Trading and Markets Division as well as other offices. This first stage has involved the identification of a sample--approximately 60 in number--of companies whose initial offerings of securities were "hot issues" in the 1961-62 and 1968-69 markets. An "in depth" analysis is being made of the history of each company from the effective date of the registration statement to a current date, including the distribution of the securities, the development of a trading market, and the investment experience of persons who purchased in the initial offering and earlier.

Beginning in January, the public hearing phase will involve an even more intensive study of about ten of the issuers previously analyzed. Witnesses will be called, testimony adduced and exhibits offered in evidence. Finally, stage three will be a report by the staff to the Commission with recommendations, if appropriate, for revisions to or additions of forms and rules and, if necessary, legislative proposals.

What we are aiming for is more meaningful disclosure on the prospects and operations of companies coming to market for the first time as well as fair, equitable and open markets for their securities. We want to get away from the boilerplate and get down to the guts and nitty gritty of economic reality. I believe that this inquiry will be a significant step in accomplishing these goals.

We are on the way to greater clarity and certainty in the rules governing the sale of restricted stock. Two months ago we published proposed revised Rule 144 designed to protect investors by making public information available for the trading markets while, at the same time, creating greater certainty as to when and how restricted securities may be resold. Last month we closed our comment period and our staff is actively reviewing approximately 150 comment letters. Most of them said "Yes, but. . ." and all together they went on for some 675 pages. I am not going to get into the details at this time, other than to indicate to you that reform in this area has been long over due and we intend to adopt the necessary rules around the turn of the year.

Going beyond factual information to research and investment judgment, we have in this country developed a corps of over 13,000 security analysts who interpret performance and measure values. This is a great resource capable of giving American investors guidance available nowhere else in the world and it contributes enormously to public confidence. I believe that during 1972 we will make even greater progress in making investment research available to the individual investor. I believe this will be done in a number of ways:

1. Companies will increasingly recognize that most of their shares are held by individuals more inclined to add to their holdings than to sell. They will cultivate this source of new capital by giving them more meaningful reports on the progress, problems and prospects of the company, its product and markets, its technology and its relationship to the economy.

2. Budgets and earnings forecasts will, when made available at all, be made available to all and not part of the investing public.

3. The obligation of a broker to know his customer and to determine the suitability of an investment recommendation to each customer will be strengthened.

4. A broker making research conclusions on a company available to any customer will be called upon to make those conclusions known to all customers for whom he has purchased shares on the basis of earlier research on that company.

In this way, by proceeding firmly and strongly to make research and investment judgment broadly available as we have made information broadly available we further strengthen public interest and public confidence in our securities markets.

Testimony from all segments of the industry at hearings Senator Williams and Representative Moss are holding and the Commission's hearings on the structure of the markets, together with the deliberations of the task force on the Martin Report created by the exchanges and the NASD, provides a solid basis for taking several steps during 1972 to strengthen public confidence that our markets will work to produce the best price for all investors, small or large. Among those steps, I can see these clearly right now:

1. A combination of composite tape and recall box to bring all transactions out into the open to make prices, volume and quotes in all markets available to all.

2. A set of rules which will bring all existing market makers into a system designed to maximize liquidity, make competition work to narrow spreads and assure all investors that they can have an opportunity to participate at the best prices available.

3. Broadened public representation in the governance of the securities markets.

There are other important issues to which I am not prepared to speak just yet but on which I hope we will be able to set a direction shortly.

All in all, I want to leave with you my conviction that this partnership of the securities industry, its self-regulatory bodies, and the Commission, has done a great deal to strengthen the system, that it is in the course of doing more, and that the public can have confidence that the American capital markets will meet the needs and the challenges that lie ahead.