ADDRESS

of

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Recent Revisions of Rules and Forms Under the Program of the New Administration of the Securities and Exchange Commission

It is a great pleasure for me to be in New York again and to have the opportunity to discuss with you recent revisions of rules and forms under the new administration of the Securities and Exchange Commission. When I received your invitation, it occurred to me that in speaking before your group of competent working secretaries of corporations most of which, I take it, are subject to the requirements of the Securities Exchange Act of 1934, I would be justified in discussing a number of the revisions of rules and forms pertaining to such corporations which the newly constituted Commission has put into effect or has under study and consideration. I want to discuss in some technical detail the revision of the proxy rules and the related annual and periodic reporting requirements. I will also mention, but not discuss in detail, revisions pertaining to securities dealers and brokers and certain other aspects of our rule and form revision program.

First, however, let me paint with a broad stroke a few general word pictures of the Commission at the end of its first six months under the Eisenhower Administration.

The five member Commission is required by law to have no more than three of one political party. Now is the first time since the Commission was established in 1934 that there have been three Republican members. However, one of the three new members appointed by President Eisenhower is a Democrat and the five Commissioners, the new and the old, have been working together harmoniously toward common objectives.

The 1948 report of the Hoover Commission's Task Force found that the Commission "on the whole has been notably well administered," that the critics of the Commission "concede that its staff is able and conscientious, and that the Commission generally conducts its work with dispatch and expedition where speed is most essential." It also said: "There are of course some weaknesses . . . but in evaluating them, one should keep in mind the basic fact that the Commission is an outstanding example of the independent commission at its best." I can assure you that my personal observation of the Commission, as presently constituted, and the vast majority of the Commission staff bears out this reputation for high professional service by men dedicated to the public interest.

When we went to work last summer, we inaugurated a broad program of study of the rules, regulations and forms which have grown up at the Commission over a period of twenty years. Our objective was to simplify, streamline and speed up the administration of the statutes committed to our charge. We believed that the basic investor protections afforded the American public by these laws could be strengthened and enhanced by a realistic, practical and vigorous administration. We feel that these

objectives can be accomplished within the framework of a budget for our agency considerably reduced from budgets of prior years and are consistent with the policy of this Administration (as expressed in the President's budget message of January 21, 1954) "to improve the management of Government activities and to find better and less expensive ways of doing the things which must be done by the Federal Government."

Also, all of us at the Commission are aware of the importance of a proper administration of the securities laws to the free flow of investment capital, and particularly the free flow of equity capital, into American industry. You will recall that in his letter of March 29, 1933, transmitting the original recommendation of securities legislation to the Congress, President Roosevelt stated that "The purpose of the legislation I suggest is to protect the public with the least possible interference to honest business" and, in his recent Economic Report, released on January 28 of this year, President Eisenhower recognized that "It would be desirable to simplify the rules and thus reduce the costs of registration of new issues and their subsequent distribution."

I want to emphasize at the outset the dedication of the present Commission to the philosophy of the laws we administer. The public interest, the protection of investors and, under the Holding Company Act, the protection of consumers, are our statutory objectives. Theodore Roosevelt said "Walk softly but carry a big stick" so I hesitate to emphasize the point further by speaking, but I do want to leave in your minds the impression that this Commission is engaged in a vigorous enforcement of the federal securities laws.

Now let me turn to some of the things we have done or are in the process of doing in the area of rule and form revision.

We have eliminated the requirement for filing of quarterly reports of gross sales and operating revenue. Because of short term and seasonal business changes and the frequent occurrence of a net earnings trend contrary to the gross trend in a company, these 9-K reports were abolished.1/

We have adopted rules under the Securities Act, and complementary rules under the Holding Company Act, which will eliminate the delay in offering of securities to be offered at competitive bidding and will dispense with the necessity of obtaining routine supplemental orders previously required. Under these rules, the post-effective amendment to the registration statement will become effective automatically on filing in one of our regional or branch offices and no supplementary order under Rule U-50 is required if two or more bids have been made for the securities.2/

1/ Securities Exchange Act Release No. 4949.

2/ Securities Act Release No. 3494; Holding Company Act Release No. 12298.

We have simplified the so-called "when issued" trading rules which will eliminate 14 rules and two forms.3/

We are considering revision of the numerous forms used by officers, directors and others for reporting the ownership or changes in ownership of securities of companies subject to the Securities Exchange Act, the Holding Company Act and the Investment Company Act, so that the seven forms now used for these purposes may be simplified and consolidated into two or three forms. We are reviewing the reporting rules under Section 16 of the Securities Exchange Act relating to short swing trading by directors, officers and 10% shareholders. We think the present rules and forms are needlessly complicated. To meet a particularly pressing problem which may not have been comprehended within Section 16(b) of the Act, we have released for comment a proposed revision of Rule X-16B-6 which would exempt certain dispositions pursuant to mergers or consolidations or reclassifications of securities, or to transfers of assets from one corporation to another in consideration for the issuance of securities.4/

We are studying the form for registration of employee stock offerings with a view to expanding its use. The present Form S-8 provides wide latitude for the use of the issuer's annual report to security holders and other published material readily available. We are studying the possibilities of amending the rules for the use of the form to permit its use by a larger number and more varied types of employee stock offerings, and revising the form itself so as to make it available for offerings under employee stock option plans.

We also have under consideration a simple form which would be available for registration of offerings of institutional grade debt securities. It is hoped that such a form will make possible faster, simpler and less expensive registrations of such debt issues, on a basis more nearly competitive with private placements. We contemplate using our acceleration power under Section 8(a) of the Securities Act to permit such issues to be registered more quickly than at present.

The revisions I have just discussed in some detail are those I think you may be most interested in as secretaries of corporations registered under the Securities Exchange Act, but just let me list a few others:

We have adopted new forms for registration under the Investment Company Act of management investment companies, and for registration under the Securities Act of securities of open end investment companies, and related rules.5/ We have put out for comment a proposed rule which

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3/ Securities Exchange Act Release No. 4989.
4/ Securities Exchange Act Release No. 4998.
5/ Investment Company Act Releases Nos. 1932 and 1933.

would prescribe standards under which Canadian investment companies may register as investment companies and offer their securities for sale in the United States.6/ We have adopted a new rule requiring brokers and dealers to file financial statements with their applications for registration,7/ a new 9-item form for registration of securities brokers and dealers instead of the former 27-item form,8/ and simplified forms and reports of brokers and dealers associations to eliminate voluminous exhibits containing information otherwise readily available.9/

We have adopted a rule relieving exchanges on which a security is admitted to unlisted trading privileges from reporting information which duplicates information reported by the issuer where the security is fully listed on another exchange.10/

We have put out for comment a proposed rule to exempt from competitive bidding issues of state regulated utility subsidiaries of holding companies, where the issuance of such securities is entitled to exemption from the Public Utility Holding Company Act of 1935,11/ and also a proposed simplified rule, designed to supplant the present complex rule, relating to permitted financial connections of officers and directors of companies in holding company systems.12/ A revised annual reporting form for service companies in holding company systems has been adopted.13/

So much for the general program.

The new revision of Regulation X-14, the proxy rules, was promulgated on January 6, and the concurrent revisions of Forms 10-K, 8-K, the annual and current reports, and the rules pertaining to Form 8-A, the form for registration of additional amounts of listed securities, were promulgated on January 28, 1954.

The Commission has surveyed in a single broad sweep the over-all reporting problems presented by Sections 12, 13, 14 and 15(d) of the Securities Exchange Act of 1934 and attempted to deal with these problems as a unified whole. Section 12 provides for rules governing applications for registration of securities on national securities exchanges, that is, "listing applications"; Section 13 provides for current reports of companies whose securities are listed; Section 14 provides for rules

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6/ Investment Company Act Release No. 1945.
7/ Securities Exchange Act Release No. 4902.
8/ Securities Exchange Act Release No. 5000.
9/ Securities Exchange Act Release No. 4942.
10/ Securities Exchange Act Release No. 4914.
11/ Holding Company Act Releases Nos. 12217-X, 12314 and 12236.
12/ Holding Company Act Release No. 12242-X.
13/ Holding Company Act Release No. 12287.

relating to the solicitation of proxies, and Section 15(d) provides for reporting requirements for companies which have registered securities under the Securities Act of 1933 but are not otherwise subject to Commission requirements. These last are the so-called "undertaking companies" because of the undertaking agreement to file current reports contained in their 1933 Act registration statements.

In the past, these sections of the statute have led to the adoption of separate and perhaps seemingly unrelated rules and forms. Piecemeal revision created a number of problems, not only for the Commission but also for industry in responding to the Commission's requirements.

Companies which filed both annual reports on Form 10-K and proxy statements had to provide the information required by various items for these purposes which dealt with the same subject matter but differed in some respects from each other. The scope of the 10-K report differed somewhat from that of the proxy statement. These differences caused a duplication of effort on the part of the reporting companies and an unnecessary and expensive administrative problem for the Commission in handling and reviewing similar but different material.

In our study of the problem, it also developed that it might be possible to dispense entirely with the requirements for the registration of additional shares of a listed security on Form 8-A by properly integrating the various requirements of the other forms. Not only did it appear that the whole reporting machinery could be simplified but it also became apparent with some revision in the rules and in the internal handling of material received by the Commission that the changes would be of real assistance to the public.

We therefore reviewed the requirements of the various rules and forms as part of a single disclosure problem. There appeared to be no good reason why a company which solicits proxies should be required to duplicate the information contained in the proxy statement in an annual report which, in practice, is filed with the Commission in most cases within two or three months after the proxy material. By making minor changes in the proxy rules, we determined that the information required by the rules would be entirely adequate for purposes of an annual report with respect to the subject matters covered by those rules.

The additional non-financial information required for purposes of a 10-K annual report which are not contained in the proxy statement was limited to three or four items of information which could be prepared very easily by every reporting company.

The Commission's experience under the rules which permit incorporation by reference has indicated that many people will duplicate information rather than incorporate it. In order to make our plan effective, we made it mandatory that companies soliciting proxies shall not respond to those items in the Form 10-K which have their equivalent

in the proxy statement, and that a company which solicits proxies shall file a Form 10-K consisting only of those items of information not called for by the proxy rules.

We are hopeful that these revisions of the Commission's reporting requirements will give further impetus and incentive for the publication of reasonably detailed annual reports to shareholders. Under the proxy rules, financial statements contained in the annual report sent to shareholders may be incorporated by reference in the proxy statement provided they comply with the Commission's accounting rules. Under the revised Form 10-K, financial statements contained in the proxy statements or in the annual reports to shareholders may also be incorporated by reference where they substantially meet the requirements of Form 10-K. Thus shareholder reports which contain the necessary information, particularly as to financial statements, can be used as annual reports to shareholders to satisfy part of the requirements for proxy filings, and also to satisfy part of the requirements for annual reports to the Commission.

It is expected and hoped that more and more shareholder reports will include balance sheets and profit and loss and surplus statements which meet the Commission's accounting requirements. Such a development will be of mutual benefit to shareholders and management alike. Shareholders will obtain the information considered necessary for informed investment analysis, and corporate managements will be able to concentrate on the preparation of one set of financial statements where formerly more than one might have been used.

Heretofore, the Commission has never required companies which do not solicit proxies under the proxy rules to transmit to the Commission copies of reports to shareholders. Companies which solicit proxies have for many years been required to transmit their reports to shareholders to the Commission subject to the proviso that they would not be considered as "filed" with the Commission or subject to the liabilities of Section 18 of the Securities Exchange Act of 1934. That is the section that provides civil liability for misstatements contained in reports filed with the Commission under the 1934 Act.

In revising our reporting requirements, we have provided that all companies subject to Sections 13 or 15(d), whether or not they solicit proxies, shall transmit their reports to security holders to the Commission and we propose to include such reports in our public files with the 10-K reports. This requirement for the first time will make these annual reports to shareholders of listed companies which do not solicit proxies generally available to the public and should contribute to an understanding of the financial and other information required under the Commission's regulations. We continue for the soliciting companies, and extend to the non-soliciting companies, the exclusion of these reports to shareholders from liability under Section 18.

The changes in procedures regarding the registration of securities on a national securities exchange will also effect substantial savings. Under the previous practice, registration of a security on an exchange under Section 12 of the Securities Exchange Act of 1934 became effective only as to a specified number of shares or a specified amount of a class of security, so that if additional shares or amounts of the same class were subsequently issued, a new application on Form 8-A was required for registration of the additional amounts.

Under the revised rules, the original application for registration is deemed to apply for registration of the entire class, and the registration of unissued shares or amounts becomes automatically effective when they are issued. This eliminates the old requirement that applications be filed for registration of additional amounts of a listed class of security. The result will be a considerable saving of time and expense both to issuing companies and the Commission. At the same time, investor protection will in no way be diminished because the necessary information will be available in the periodic reports currently filed with the Commission on Form 8-K. This form, incidentally, has also been revised so as to limit its requirements to events of such material importance to security holders as require a report on a current basis. The issuance of additional securities in material amounts has always been considered such an event.

These changes in the aggregate will simplify materially the work involved in complying with our requirements, will reduce substantially the administrative burden of the Commission and will eliminate approximately 500 applications annually on Form 8-A.

Now, as to the revised proxy rules, many of the changes are of a clarifying nature.

It has been made clear that the law of the state of incorporation is the standard for determining what is a proper subject for action by security holders in connection with security holders' proposals. This reference to state law is entirely consistent with the previous proxy rules and, indeed, is the only frame of reference, in the absence of any direction from Section 14 of the Securities Exchange Act, that is possible. I submit that it is consistent with the decision in the so-called Transamerica case.[14/] In that decision, the court found affirmative authority under Delaware law for submission of one of the three proposals and no lack of authority for the two others and simply struck down a corporate by-law which would have placed a procedural block in the way of their consideration by the shareholders. The new proxy rule is in entire accord with the legal bases of that decision and consistent with the court's statement that "a corporation is run for the benefit of its stockholders and not for that of its managers."

14/ SEC v. Transamerica Corp., 163 F. (2d) 511.

The former Associate General Counsel of the Commission, now Professor of Law at the Harvard Law School, Louis Loss, has written in his authoritative treatise: "Where the state law is clear that a particular matter is for the directors alone, that would seem to be decisive; if Congress had intended to give the Commission power to reallocate functions between the two corporate organs, so revolutionary a federal intervention would presumably have been more clearly expressed. This would approach federal incorporation in all but name. As we have seen, federal incorporation proposals have recurrently appeared in Congress." Let me add, not enacted.

The revised proxy rules now specifically provide that management may omit from its proxy material a security holder's proposal which relates to the conduct of the ordinary business operations of the issuer.

Also, a new provision has been adopted to relieve management of the necessity of continuously repeating in its proxy material security holder proposals which on previous submissions have received little security holder support. Under the amended rules, a security holder's proposal may be omitted from management's proxy material if it was submitted within the previous five years and received less than 3% in the case of a single submission, less than 6% upon a second submission or less than 10% upon a third or subsequent submission during such five year period. Also, the new rule requires data about all the directors even though, because of staggered terms, less than all are standing for election.15/

These revisions have caused considerable public comment. Some say we are undermining corporate democracy and impairing the position of minority stockholders. Others urge that the rules should be further modified to relieve management from various provisions alleged to be burdensome.

I should like to make clear a point which seems to have been overlooked by many who have been extremely vocal on both sides of the issue. The Commission believes, under the Acts of Congress it is sworn to support, that the proxy rules, indeed all of its rules, should be promulgated and administered to serve the public interest and the protection of investors. We believe the new proxy rules meet that test.

Section 14 of the Securities Exchange Act of 1934 makes it unlawful to use the mails or instrumentalities of interstate commerce to solicit proxies in respect of securities registered on any national securities exchange "in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors." Although abuses by corporations of the proxy soliciting mechanism were specifically referred to, the Committee Reports and other guides to legislative intent give

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15/ Securities Exchange Act Release No. 4979.

the Commission little help in precisely determining what kind of rules and regulations the Congress had in mind that the Commission should adopt in this field.

The Commission attempts to construe the statutes it administers by looking first to the statutes themselves for guidance. Let me give you an example. Section 6(b) of the Public Utility Holding Company Act of 1935 provides that "the Commission by rules and regulations or order, subject to such terms and conditions as it deems appropriate in the public interest or for the protection of investors or consumers, shall exempt from the provisions of subsection (a) the issue or sale of any security by any subsidiary company of a registered holding company, if the issue and sale of such security are solely for the purpose of financing the business of such subsidiary company and have been expressly authorized by the State commission of the State in which such subsidiary company is organized and doing business." The subsection (a) referred to provides for the filing with the Commission of a declaration regarding a financing plan and the taking of action by the Commission to make such declaration effective. Declarations relating to a financing plan may only become effective if they meet the requirements of Section 7 of that Act, which lays down standards as to the types of securities which registered holding companies and their subsidiaries may issue.

We have recently put out for comment a proposed new rule which would exempt from the competitive bidding requirements of the Commission securities of subsidiary companies the issue and sale of which have been expressly authorized by the state commission. What did the Congress mean when it said the Commission "shall" exempt securities expressly authorized by State commissions? We have this very day in Washington commenced a public hearing on the proposal and we will listen to and study the comments of state commissions, utility companies, investment bankers and others on the difficult questions of statutory interpretation involved.

Many of the responsibilities of the Commission, including those imposed by Section 14 of the Securities Exchange Act of 1934, represent a venture on the part of the federal government in a field which, even after 18 years of administration, is relatively new. The proxy rules have been amended half a dozen times since the first approach was made in 1936. Not until December of 1942 did the Commission first adopt the shareholder proposal rule. After its adoption, it was feared that the Commission was attempting to minimize the rights of minority shareholders. Bills were introduced in Congress to limit the Commission's power. The then Chairman of the Commission, in hearings in June of 1943 before a Subcommittee of the Committee on Interstate and Foreign Commerce of the House of Representatives, testified in defense of the rules and no bill was enacted.

An industry representative at the hearing before the present Commission on December 16, 1953, argued that the earlier Commission had lulled the Congress to sleep in promulgating the rule after the session adjourned in 1942, but it seems to me that the failure of enactment of a bill limiting the Commission's power, and the subsequent election of five Congresses without amendment of Section 14 of the Act, should be considered in this connection. In any event, the then Commission assured the Congressional Subcommittee in 1943 that the proxy rules would be beneficial to minority shareholders and, indeed, to shareholders generally, and that the Commission in its administration of the rules would see to it that they were not abused.

The changes we have just made in the proxy rules should be regarded as a further step in an evolutionary process begun in 1936. The changes have not been made for the purpose of satisfying any particular group. In the considered judgment of the Commission, concurred in by its experienced staff, the revised rules will better serve the public interest and the interest of investors generally.

Incidentally, the revision has not altered the long-standing provision of the proxy rules, Rule X-14A-7, which enables a shareholder to communicate with other shareholders when the management is soliciting proxies. Under this provision, the management may not solicit proxies unless it is also willing to transmit proxy soliciting material submitted by shareholders at their expense. This provision eliminates the possibility that shareholders may be deprived of the right to obtain a list of other shareholders in time to communicate with them before the meeting. In such proxy soliciting material prepared and submitted by a shareholder, he may solicit proxies to vote at the meeting for candidates for election as directors as well as seek expressions in favor of proposals stated in the proxy soliciting material.

The 3, 6, 10% progression deprives no one of the right of advocacy. It merely places a limitation on that right which serves the interest of shareholders generally. As a matter of fact, a proposal for a five and ten percent step-up initiated within the Commission was considered as long ago as November of 1951. The new Commission, indeed, cannot claim a copyright on the idea of the progressive percentage increases embodied in the new proxy rule.

Democracy is not inconsistent with a form of government in which the majority speaks through chosen representatives. The history of governmental organizations in America, and indeed the history of the development of corporate organizations, bears out this thesis. In American political democracy, the people speak through their representatives in the state legislatures and in the Congress. But the "initiative" or legislative proposal initiated by the people directly rather than by the legislature, thought by its proponents in the last decade of the nineteenth and early in the twentieth century to be the ultimate improvement in political democratic methods, has proved

virtually useless in the states which have tried it. In corporate democracy, the people act through their directors whom they, as shareholders, elect. The ultimate and truly democratic recourse of the shareholder against a management unsatisfactory to him is to unseat the Board of Directors. There have been many successful proxy fights that have been waged by dissatisfied shareholders under the proxy rules administered by the Commission.

In political organizations, candidates for public office are often required to supply a specified number of signatures in order to get on the ballot. The former Mayor of your city -- New York -- was ineligible to run for reelection because an insufficient number of citizens validly signed his nominating petition. President Eisenhower expressed in his State of the Union message a year ago "dedication to the well being of all our citizens" and emphasized in his radio speech to the nation just after New Year's this year that this Administration's program is "inspired by zeal for the common good." Applying that to the securities law standard we are sworn to support -- namely the public interest and protection of investors -- I think that means the general public interest and the protection of investors generally in the administration of our admittedly broad power under Section 14 of the Act.

In ten years of the shareholder proposal rule, only 181 shareholders out of the millions of American shareholders of registered companies submitted proposals, a large proportion of all shareholder proposals were submitted by three individuals or groups, no proposals so submitted have carried and the vast preponderance have been voted down by overwhelming vote of the shareholders voting.

The Commission and its staff are familiar with shareholder proposals since 1943. We have concluded that shareholders generally are entitled, in the true sense of corporate democracy, to require a minimal showing of shareholder acceptability and continued progress as conditions of continued resubmission of shareholder proposals in management proxy soliciting material.

I want to make it perfectly clear, and I welcome the chance to say this directly to a chapter of the American Society of Corporate Secretaries, that the revision is not intended to be responsive to some of the arguments presented by representatives of the Society or of certain corporations who appeared before us at the hearing on Dec. 16, 1953. These representatives made some arguments that you may want to do some further thinking about as the coming year rolls on. I question whether all of the data that could be gotten together has been presented to you. The argument was made that shareholders submitting proposals should defray the cost of their submission in certain cases, but in response to a question from the Chairman of the Commission as to the cost to corporations of shareholders' proposals, it was stated that no attempt to compile such costs had been made. From your standpoint, this argument might lead to the suggestion that management should defray

the cost of management proxy soliciting material by which management gets elected to office year by year. How seriously would your organization back the argument that a corporation should not pay whatever cost there is in including shareholder proposals in the management proxy soliciting material?

The argument was made before us that "the security holder has a basic weapon to defend his independence which the citizens of the most ideal democracy do not possess, namely, he can express his disapproval of a company's policy by severing his connection with it." In other words, if a shareholder doesn't like the way a company is being managed, he can sell his shares. Would the financial officers of companies which have had to go into the market to raise equity capital or which, because of the need to retain earnings in their businesses for use as equity capital, have been interested in seeing that the market values of the shares were well preserved, feel very happy about this argument? I am sure this viewpoint does not represent the views of the vast majority of American management.

Thank you very sincerely for the opportunity to tell you what the new Commission has been doing and plans for the immediate future in the field of rules and forms under the various Acts we administer.