Problems Under the Securities Act of 1933 and the Securities Exchange Act of 1934

THE CURRENT LEGISLATIVE AMENDMENT PROGRAM

Address of

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Although the broad title of the program for this afternoon is "Problems under the Securities Act of 1933 and the Securities Exchange Act of 1934," you will see if you read the small type that the discussion is principally directed toward the current legislative amendment program. The presentation will begin with a paper which I will read covering, in as short a space as can do justice to the subject, the background, scope and purpose of the bills which have been pending in Congress this winter and spring -- one of which is, we hope, approaching enactment.

After that, John W. Lindsey, Esq., Counsel for the National Association of Securities Dealers, Inc., one of the industry groups which presented views to the Congressional Committees and the Commission, will speak for a few minutes. Then Mr. Lindsey, Manuel F. Cohen, Esq., Counsel for the Commission's Division of Corporation Finance, Mr. Charles H. Eisenhart, one of the Assistant Directors of that Division, and I will answer your questions and discuss the bill in detail to the best of our respective abilities. At 4:00 p.m., we will go on to accounting problems, which I will introduce separately at that time.

So, with your permission, I will now begin the discussion of the legislation.

I want to make one thing perfectly clear. The laws we administer are enacted by the Congress and not by the Commission. The pending legislation I am about to discuss represents the hard and able work of Congressional Committees. The Commission's role in its formulation was to assist, and make recommendations to, the Committees of Congress but to do no more than that.

In discussing the legislation I will assume that you know something about the existing laws: the Securities Act of 1933, which regulates the issuance of new securities; the Securities Exchange Act of 1934, which regulates national securities exchanges, brokers and dealers, and companies whose securities are listed on such exchanges; the Trust Indenture Act of 1939, which provides certain standards for indentures securing debt securities publicly sold; and the Investment Company Act of 1940, which regulates the so-called mutual funds. I am not referring to the Public Utility Holding Company Act of 1935 or Chapter X of the Bankruptcy Act of 1938 because the bill I am about to discuss does not pertain to those acts.

All of us who have done legal work in securities realize that these basic laws, particularly the Securities Act and the Securities Exchange Act, have done a great deal toward the re-establishment of investor confidence in securities from the low state to which securities had fallen in public favor by 1933. These acts are based on the premise that investors in new securities and holders of outstanding securities of listed companies whose securities are listed on national securities exchanges should be supplied with full, complete and accurate information concerning the issuer's business, its finances and the terms upon which its securities are sold to the public. I personally believe that the restoration of investor confidence brought about by these laws has been a substantial contributing factor in the preservation of the free enterprise system in America over the last twenty years. Look abroad and see what has happened in other countries, once capitalistic and now socialistic or worse, which succumbed as the United States did to the great depression of 1930-1932, and you can see the direction which might have been followed in this country had investor confidence not been restored.

With this general background, I am sure you can understand that neither of the Committees of the Congress, with whose members and staffs we have been collaborating, would be the least bit interested in any amendments of these laws which would in any way diminish the protection afforded by them to the American public, nor would we at the Commission recommend or accede to any amendments which we thought might have such an effect.

However, I am sure you will realize that in the administration of laws on the statute books for the better part of twenty years, no matter how carefully drafted initially -- and these laws were extremely well drafted -- "bugs" develop. Some provisions once thought necessary and appropriate turn out on experience not to be necessary or to have a hampering administrative effect. Both of the Congressional Committees have been aware of this for a long time and legislative programs are not new in the Commission. As a matter of fact, the Commission participated in amendment programs in 1941 -- this was a very comprehensive program but was sunk at Pearl Harbor -- and in 1946, 1947, 1950 and 1951. None of these resulted in the enactment of legislation, however, although a great deal of work and study was done in connection with them. A Subcommittee of the House Committee on Interstate and Foreign Commerce held an exhaustive investigation of the activities of the Commission in January, February, March and June of 1952, and in its report dated December 30 of that year concluded as follows:

> "The subcommittee has heard numerous proposals for amendments to the several acts administered by the Commission. No attempt was made to secure full comment or rebuttal from all sectors of the industry or the administrative agency on each proposal advanced.

"Indeed, even had the fullness of the testimony made it possible, an analysis in many cases would be extremely difficult owing to the highly technical character of the subject matter, the nature of the ramified operations covered, the purpose for which the legislation is intended, the expertness required in properly appraising and evaluating the merits of any controversial issue, and the continuing requirements of the public interest. The subcommittee, accordingly, is of the opinion that at this time the Commission should reactivate its conferences, and the industry and the Commission earnestly and energetically attempt to resolve their differences, at least in those areas where concurrence already seems possible, and propose a program on these at the earliest opportunity." 1/

With this background, after Ralph Demmler, our Chairman, assumed office on June 16 of last year, he and the other members of the Commission conferred with Senator Capehart of Indiana, Chairman of the Senate Banking and Currency Committee, to determine what position the Commission should take in reference to various industry groups which wished to submit proposals for amendment of the statutes administered by the Commission. Senator Capehart referred to the continuing responsibility of the committees of the Congress under Section 136 of the Legislative Reorganization Act of 1946 2/ to appraise the Commission's administration of the laws subject to its jurisdiction and in the development of amendments or related legislation, and he suggested that a program be worked out under the guidance of Senator Bush of Connecticut, Chairman of the Subcommittee on Securities, Insurance and Banking.

At about the same time, preliminary conversation was had with the staff of the House Committee on Interstate and Foreign Commerce. Representative Wolverton, as some of you may know, is the Chairman of that Committee and is one of the most distinguished members of the House of Representatives, having served continuously since November 1926 and having been a member of the House Committee at the time the Securities Act of 1933 and the Securities Exchange Act of 1934 were passed. He is thoroughly familiar with the conditions that led up to the enactment of these laws and with the continuing administration of them over the years by the Commission. He instructed the Commission on August 21, 1953 in the following words:

"It seems to me that no harm, and, indeed, much good might arise from a continuation of the discussions which you have had with industry and affected persons over the years in the development of technical changes which might be made to the Acts and which you would propose to bring to our attention for consideration.

1/ House Report No. 2508, 82d Congress, 2d Session, pages 4-5.
2/ 60 Stat. 832

"On the other hand, you will appreciate, I am sure, that I am most zealous in preserving for the investing public the protection which was envisaged in the statutes when they were passed, both as they apply to investors in new securities and as they apply to purchasers on the Exchanges and over-the-counter markets. I certainly would feel that it was unincumbent upon any agency charged with administering these Acts on behalf of the Congress for the protection of the general public, to initiate or sponsor any program which would weaken such protection, though conversely, it might well give thoughtto areas in which it could be strengthened."

The present Commission is entirely in accord with the thoughts thus expressed.

So armed, on August 26, the Commission issued a press release stating that "if proposals are presented for amendment of the laws which it administers, the Commission will hold itself in readiness to render such assistance as the appropriate Committees of the Congress may request of it." During September, October and November, we received numerous legislative proposals from various organizations and individuals.

Legislative proposals of earlier years had been handled on staff level at the Commission. We decided that consideration of these proposals should be given by the Commission itself, but with the advice of staff representatives of our Corporation Finance and Trading and Exchanges Divisions and our General Counsel.

On October 19, 1953, the Commission met with the Senate Subcommittee and its staff to review certain of its proposals and those submitted by industry representatives and obtained views as to those which could be embodied in a bill which might be satisfactory to the Subcommittee and which could be recommended by the Commission. On November 4, the Senate Subcommittee met with industry representatives and the Commission for another all-day conference at which the Commission and industry proposals were discussed and the substance of the proposals which would be satisfactory to the Committee were indicated.

Now up to this point all of the matters except the very important so-called "Section 5 problem," that is the possible amendment of Section 5 of the Securities Act of 1933, were covered, but this problem, being the most important single matter, was left for separate discussion. On November 18, the Subcommittee again met with the Commission and on November 24 met with industry representatives and the Commission on the Section 5 problem.

As a result of these conferences, an ad hoc industry drafting group went to work and on December 14 submitted a draft bill for consideration by the Commission. At the same time, the Commission's

drafting group was independently at work in the preparation of a bill. The Commission held further conferences with the industry drafting committee on December 29, 1953, and on January 12, 1954. The Commission draft bill was made the basis of these conferences, the purpose of which was to embody in the necessarily detailed technical legislative language the substance of the matters agreed upon at the meetings with the Senate Subcommittee. On January 25, the Commission submitted its draft bill to the Chairmen of the respective Committees. Senator Capehart introduced S. 2846 and Representative Wolverton introduced (by request) H.R. 7550, identical bills, on January 27.

On January 28, 1954, President Eisenhower in his Economic Report to the Congress pointed out the reason and desirability of the modifications provided for in the bill when he stated:

> "The Federal securities laws were enacted nearly 20 years ago and have remained largely unchanged over that period. Some modifications in these laws are needed which, while fully protecting the interests of investors, will make the capital market more accessible to businesses of moderate size. It would also be desirable to simplify the rules and thus reduce the costs of registration of new issues and their subsequent distribution." 3/

Public hearings were held before the Senate Subcommittee on February 3 and 4. On February 10 the Chairman, Senator Capehart, received the formal advice of the Executive Office that "enactment of S. 2846 would be in accord with the program of the President." After executive sessions of the Subcommittee and the full Committee, on February 26 the Senate Committee on Banking and Currency reported the bill out favorably and recommended its passage. The Committee Report contains an excellent summary and analysis of the bill, both by subject matter and by sections, together with a Cordon Rule print of the bill which shows the changes it would effect in the existing statutes. 4/ I commend this report to anyone wanting to make a detailed study of the bill.

The bill passed the Senate on the consent calendar on March 2, 1954. 5/

3/ Economic Report of the President, January 28, 1954, 83rd Cong., 2nd Sess., House Doc. No. 289, page 88.

4/ Senate Report No. 1036, 83rd Cong., 2d Session.

5/ Congressional Record, March 1, 1954, page 2281, and March 2, 1954, pages 2242-2246.

Thereafter, on March 19, 1953, a public hearing was held before the House Committee on Interstate and Foreign Commerce at which its Chairman, Representative Wolverton, presided on the bill and its House counterpart, H.R. 7550.

On April 13 the Committee met to consider these bills in executive session, and on April 15 reported S. 2846 to the House. 6/ However, Section 6 of the bill, which provided that Section 3(b) of the Securities Act be amended to increase the exemption from $300,000 to $500,000 was stricken from the reported bill. On April 23 the Report of the Committee, by Representative Dolliver, was filed and the bill committed to the Committee of the Whole House on the State of the Union with the amendment just referred to and certain other minor amendments of a drafting and technical nature. 7/ Like the Senate Committee Report, the House Committee Report also contains excellent summaries and analyses of the bill, together with a comparative print. Also, the House Report contains a very full and helpful discussion of the purposes of each of the substantive amendments with pertinent quotations of testimony given by Commission and industry witnesses at the hearing. The reasons for the Committee's rejection of the proposed increase in the exemption from $300,000 to $500,000 are ably marshalled and set forth in this report. 8/

On May 10, the Rules Committee of the House granted a rule providing for consideration of the bill under the one-hour rule. 9/ The next day the House adopted the rule and debated the bill for an hour or so 10/, and on the following day the Committee amendments were adopted by the Committee of the Whole and the bill, as so amended, was passed by the House. 11/

On May 18 the Senate disagreed to the House amendments, requested a conference, and appointed Senators Capehart, Bush, Bricker, Ives, Frear, Robertson and Sparkman as conferees. 12/ On May 20, the House insisted on its amendments and appointed as conferees Representatives Wolverton, Dolliver, Heselton, Bennett, Priest, Harris and Rogers. 13/

6/ Congressional Record, April 15, 1954, page D420.
7/ Congressional Record, April 23, 1954, page 5237.
8/ House Report No. 1542, 83d Congress, 2d Session.
9/ House Resolution 527, Congressional Record, May 10, 1954, pages D503-D504, 5938, 5973.
10/ Congressional Record, April 11, 1954, pages 6060-6071.
11/ Congressional Record, May 12, 1954, pages 6106-6112.
12/ Congressional Record, May 18, 1954, page 6383.
13/ Congressional Record, May 20, 1954, pages 6522, 6547.

The only amendment in controversy is the proposed change in the exemptive amount provided by Section 3(b) of the Securities Act. Up to the present time, the conferees have not met.

So much for the formulation of the bill and its introduction and course to date in the Congress. Now let me tell you about the bill itself. Let me start with a general comment. As I mentioned, the Commission has every desire to see the basic philosophy and purposes of the Acts held intact. The Commission believes that the proposed amendments will not change the existing responsibilities of the sellers of securities to the public.

The good result produced by the Securities Act has come in great measure from the fact that the issuer and the underwriter must come forward and make a public statement concerning the issuer's business, its finances, its securities and the proposed offering -- and all of this under stern statutory liabilities, both penal and civil. This requirement of disclosure is itself a substantial deterrent to transactions which would not stand the light of day. The imposition of liability for inaccurate and incomplete information and the administrative processing by the Commission of material filed with it have improved corporate morality, accounting standards and standards relating to business information generally.

These amendments in no way curtail the duty to disclose or the liability for non-conformity to the disclosure requirements, nor is there any decrease in the administrative powers of the Commission.

The most important change involves Section 5 of the Securities Act of 1933. Many of the other amendments are necessary to accommodate other sections of the Securities Act to the amendment of Section 5.

The change in Section 5 and the related changes have to do principally with the mechanics of the distribution of securities. These changes must be considered against the background of the present act and practices thereunder.

The Securities Act presently makes unlawful the offer or sale of a security to the public by mail or instrumentality of interstate commerce, such as the interstate telephone, until a registration statement with respect to the security has been filed with the Commission and becomes effective. Oral offers prior to effectiveness are not made

unlawful by the Securities Act of 1933, that is, oral offers within the state. The period between the filing date of a registration statement and the effective date averages about 20 days. The seller of a security must deliver to the purchaser a prospectus containing a summary of the information in the registration statement.

It is clear from the legislative history of the Act that the Congress intended that by dissemination of information during the waiting period the public would become informed of the essential facts relating to a proposed issue before the effective date of the registration statement.

The securities industry has contended for many years and in my personal observation it is a fact, that, in practice, the free flow of information concerning a new issue during the waiting period has been restricted because of the fear of underwriters and dealers, not to mention their lawyers, that communications to prospective customers might be construed to be illegal "offers" of a security before the effective date of the registration statement. This fear springs from the criminal penalties provided for violation of the statute and also from the fact that a violation of Section 5, based on a strict construction of the term "offer," might give the purchaser a right of rescission for one year under Section 12(1) of the act.

The Commission has recognized that the distinction between "dissemination of information" and an "offer" is difficult to draw and still more difficult for a customer to appreciate, and has been concerned through the years because the objective of a widespread dissemination of information during the waiting period has not been more effectively achieved.

Accordingly, the Commission has taken administrative actions designed to encourage issuers and underwriters to make it possible for dealers and prospective investors to become familiar during the waiting period with the information which the statute intended they should have.

From the earliest days of the Commission's administration of the Securities Act, pre-effective summaries of information as filed have been permitted. 14/

In 1946, the Commission adopted a rule (Rule 131) 15/ which provides that distribution of a preliminary prospectus before the effective date of a registration statement shall not in itself constitute an "offer." This preliminary prospectus, usually filed as part of the registration statement, is popularly called the "red herring" prospectus, because a legend is printed in red on each page

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14/ Securities Act Releases No. 464 and 802.
15/ Securities Act Release No. 3177.

stating that it is not an offer to sell or the solicitation of an offer to buy and that it is preliminary, not final.

Since adoption of Rule 131 the Commission's action in accelerating the effective date of a registration statement has been conditioned upon a showing that there had been an adequate and timely distribution of the red herring to dealers who were expected to participate in the sale of the security to the public.

This rule and administrative policy have achieved in part the original statutory objective. Since that time, as a matter of practice, underwriters and dealers who expect to participate in the distribution of a new security receive information concerning the new issue by means of a red herring prospectus, in advance of the effective date.

The red herring prospectus, however, does not lend itself to distribution to the public generally for the purpose of preliminary screening of prospective customers. It frequently cannot be secured in sufficient quantity in various parts of the country in time to permit its general use as a means to disseminate information or as a means by which underwriters and dealers may determine public interest in a forthcoming issue.

In 1952, the Commission took another administrative step designed to assist dealers to communicate with customers for the purpose of determining who might be interested in receiving the prospectus concerning a new issue. A rule (Rule 132) 16/ was adopted which provides for a short notice of proposed public offering called an "identifying statement" containing prescribed minimal general information concerning a new issue. This rule likewise provides that the use of the identifying statement shall not constitute an "offer" of a security for purposes of Section 5. An issuer is required to file the identifying statement with its registration statement and the Commission conditions its action in making the statement effective upon a showing that copies of the identifying statement have been made available to dealers and underwriters.

Underwriters and dealers have objected that Rule 132 does not permit the inclusion in the identifying statement of sufficient information to stimulate inquiries by investors for copies of the prospectus. They contend that the identifying statement fails in its purpose unless it contains more of a summary of the registration statement, including a summary of certain financial information.

These rules and policies -- that is, the rule concerning the use of the "red herring" prospectus and the use of the identifying statement, and the policy requiring the use of these documents -- are consistent with the Act. However, in view of the precise and sweeping prohibitions of Section 5, in view of the difficulty in distinguishing between the dissemination of information and the making of an offer, and in view of the difficulty of

16/ Securities Act Release No. 3453.

explaining that the use of a red herring prospectus is not an offer of the securities, even though the text of the red herring contains words which offer the securities, the bill contains amendments of the Act which would expressly support the practices which the Commission permits and indeed requires the industry to follow.

As I mentioned before, Section 5 of the present Act prohibits the sale of securities before the effective date of a registration statement and the term "sale" is defined in Section 2(3) of the Act to include an offer. Basically, the amendment would permit written offers to sell and solicitations of offers to buy during the waiting period by means of a preliminary prospectus filed with the Commission prior to its use. As already noted, the use of the telephone for the making of oral offers intrastate is not prohibited by present law. Under the amendment there would be no prohibition against such offers either interstate or intrastate. The present prohibition against the making of an actual sale or contract of sale of a security prior to the effective date of a registration statement is not affected by the amendment.

We believe that issuers, underwriters and dealers should find no difficulty in regulating their conduct during the waiting period so as not to make contracts of sale before the registration statement becomes effective. This might be done by conditioning offers, limiting activity to solicitation of offers to buy or by other means which keep the transaction short of a sale or contract of sale.

I think it must be apparent from what I have just said that the amendment does not work any fundamental change; in fact, it may fairly be said to give more specific authority for the continuance of practices which have developed over the years under the present law, and to make those practices specifically subject to the sanctions provided by the Act.

In order to accomplish these objectives, it is necessary to redefine the term "sale" in Section 2(3) and to amend Sections 5 and 10 of the present statute. As I have indicated previously, the term "sale" as presently defined includes an offer as well as a sale. Section 1 of the bill defines these terms separately.

Section 5(a)(1) of the Act continues to make unlawful the "sale" of a security prior to the effective date of a registration statement. The change in the definition of "sale" in Section 2(3), however, has the effect of eliminating the present prohibition against the making of an offer to sell or the soliciting of an offer to buy prior to the effective date.

No change is made in the present provisions of Section 5(a)(2) which prohibit the transmission of a security through the mails for purposes of sale or delivery after sale unless a registration statement is in effect.

The redefinition of "sale" to exclude offers, together with the proposed revision of Section 10 of the Act (contents of prospectuses),

will change the effect of Section 5(b)(1) of the Act to permit the making of offers during the waiting period by means of prospectuses containing summary information as well as by means of the red herring prospectus.

The present provisions of Section 5(b)(2) which require delivery of a complete prospectus in connection with a sale or delivery after sale are retained.

These changes make necessary a new Section 5(c) which makes it unlawful to offer a security prior to the filing of a registration statement.

A conforming change in Section 10 is made so as to authorize the Commission to permit the use of a summary prospectus in addition to the conventional prospectus. This short-form summary prospectus will be filed with the Commission, as part of the registration statement, and must conform to the Commission's rules and regulations. In order to prevent the use of a summary prospectus which fails to meet the Commission's requirements, the Commission will be authorized to suspend the use of a defective summary prospectus. This administrative remedy, which is intended to supplement the stop-order powers of the Commission under Section 8, is considered essential because of the necessity for speedy action to prevent the use of a defective summary prospectus during the relatively short waiting period.

Since, however, the summary prospectus will involve condensation or summarization of the full prospectus and since that process necessarily involves omission, the Commission believes, and the bill provides, that preliminary and summary prospectuses authorized by this Section should not be subject to Section 11 which imposes liabilities upon the issuer, its officers, directors and underwriters for misstatements and omissions. This will not lighten the existing burden of liability because the red herring prospectuses now permitted are not subject, as such, to Section 11 liabilities. We believe that the administrative sanctions of Section 8 and the suspension power, coupled with the liabilities of Section 12 and 17 (which provide for civil liabilities and criminal penalties against sellers), can be relied upon to guard against the use of defective summary prospectuses.

I might mention, parenthetically, at this point one further change of substance in Section 10, although it is not directly related to the Section 5 problem. Section 10(a) provides that a prospectus shall contain the information contained in a registration statement and that when a prospectus is used more than 13 months after the effective date of the registration statement, the information in such prospectus shall be as of a date not more than one year prior to its use.

The effect of these provisions has been to require more current disclosure for prospectuses employed after the expiration of the first 13 months of an offering than is required during the first 13 months.

This arises from the fact that some of the information in the registration statement at the time it becomes effective may be as of a date, in some instances as much as 6 months prior to the filing. The requirement that the information in the later prospectus be as of a date within one year of its use has presented something of a problem in many instances because it required the preparation of interim certified financial statements -- an expensive process.

The proposed Section 9 of the bill provides that when a prospectus is used more than 9 months after the effective date, the information in the prospectus shall be as of a date not more than 16 months prior to such use. It is felt that the amendment provides less discrimination between offers of short duration and those of long duration, without diminishing the quantity or quality of information supplied investors.

Returning to the Section 5 problem, under the bill the civil and penal liabilities imposed by the statute would remain unchanged. Section 12 of the present statute provides that a purchaser of a security may recover from the seller who violates Section 5 or who sells a security by means of misrepresentations or concealment in a prospectus or oral communication. Since the terms "sell" and "sale" have been redefined, the amendment to Section 12 (Section 10 of the bill) inserts the words "offers or" before the word "sells" in clauses 1 and 2 of the section so as to preserve the effect of the present law by not excluding the newly permissible pre-effective offers from liabilities under Section 12. For similar reasons, and to preserve existing sanctions, corresponding changes are made in Sections 17 and 22 (Sections 11 and 12 of the bill).

I might add that, to the extent the media of information which are permitted by the bill are more widely disseminated, it is our view that a larger segment of the investing public generally, and the smaller dealers, will have a greater opportunity to participate in the processes of capital formation.

I have spent a good deal of time on the Section 5 problem. Section 5 is often called "the heart of the Act." I will run through the balance of the bill more quickly.

The next amendment relates to the use of prospectuses after the effective date of a registration statement. Existing law requires underwriters and dealers to deliver prospectuses to investors as long as they are engaged in the initial distribution of a security. Moreover, any dealer, even though not a participant in the distribution, must deliver prospectuses to his customers in trading transactions for at least one year after commencement of an offering. The proposed amendment (Section 7 of the bill amending Section 4(1) of the act) provides for delivery of prospectuses in trading transactions during the actual offering period but in no case less than 40 days after the

effective date of the registration statement or 40 days after the commencement of public offering, whichever expires last. It does not change the requirement that prospectuses be delivered by underwriters and dealers so long as they are engaged in the initial distribution of the security.

The one year provision with respect to trading transactions has long been recognized as unrealistic. Moreover, dealers trading in a security publicly offered within one year find themselves unable to obtain prospectuses. This fact has rendered compliance by dealers and enforcement by the Commission difficult.

In view of the continuous offering of securities by certain types of investment companies, particularly those commonly referred to as "mutual funds", a special provision for mandatory use of prospectuses by dealers over a longer period is provided by a proposed amendment to the Investment Company Act (Section 402 of the bill, amending Section 24(d) of the Investment Company Act of 1940).

The next amendment is proposed for the purpose of facilitating the financing of small business. Section 5 of the bill would amend Section 3(b) of the Securities Act to raise from $300,000 to $500,000 the amount within which the Commission, subject to appropriate terms and conditions, may exempt public offerings of securities from the registration requirements of the act. The proposal will afford the Commission greater flexibility to adjust requirements to the financial needs of small issuers. The present statutory sanctions (as implemented by rules and regulations providing for offering circulars and for Commission action by order to prevent violation of such regulations) relating to small offerings will be maintained.

As I mentioned a few moments ago, the bill as passed by the House did not contain this amendment. The Committee Report states:

> "The committee can but be sympathetic to any argument urged for the facilitation of the enlistment by small businesses of capital with minimum of expense. On the other hand, the offering of securities to the public without registration under the Securities Act obviously is attended without the full protection and the substantial remedies to the investor which the act was designed to afford. The setting of a figure below which securities may be offered without registration necessarily, therefore, involves the reconciliation, as far as possible, of the conflicting objectives of protecting investors of securities, on the one hand, and of assisting the ready flow of capital into smaller industries on the other. Here, as in most fields of human activity, perfection is an unattainable ideal. Compromise and adjustment are inescapable. The Committee is of opinion

that a sufficient case has not been made for the need for the increase in the amount of the exemption to offset the decrease in the protection to investors which would flow therefrom."

The Committee pointed out that the investor does not receive the protection of Section 11 of the Act in connection with Regulation A offering circulars, and also that avenues other than the $300,000 exemption now available can be used to raise larger amounts of capital for small business. For example, the $300,000 limit is applicable within the time of one year and the exemption can be availed of over a series of years. Also, private offerings can be used and also intrastate offerings, both of which are exempt from the registration requirements of the Act.

Turning to the Securities Exchange Act of 1934, the first amendment relates to the provision covering the extension of credit by dealers on new issues. Section 11(d)(1) of the Securities Exchange Act prohibits a person who is both a broker and a dealer from "taking into margin accounts new securities in the distribution of which he participated during the preceding six months." This was intended in part to restrain distributors from selling new issues of securities to their brokerage customers on credit. The apparent purpose was to provide that new issues would be initially placed with investors rather than with speculators. It is generally agreed, however, that the prohibition against extending credit for six months after the end of the offering period is unnecessarily long.

Section 201 of the bill reduces the 6-month period to 30 days, but the amendment will not permit extension of credit by a member of the selling syndicate or group while the selling or distributing process is in progress or for 30 days thereafter. It is believed that Section 11(d) as so amended will be sufficient to assure that new issues will be sold on a cash basis.

The next amendment, relating to "when issued" trading, is designed as essentially a technical amendment to remove an ambiguity in the law. The last two sentences of Section 12(d) of the Securities Exchange Act of 1934 deal with the subject of "when issued" trading on the exchanges. The first of these two sentences provide ample authority for the regulation of such trading under the standards of public interest and protection of investors that are used throughout the act. The last sentence, which represents an attempt to deal with the problem somewhat more precisely, was apparently not fully considered, for where a security is a right or the subject of a right granted to holders of a previously registered security "when issued" trading cannot in the nature of things serve "to distribute such unissued security to such holders." Rather it provides a market in which such holders may sell the unissued security and others may acquire it.

Section 202 of the proposed bill, therefore, would repeal the last sentence of Section 12(d) thereby permitting "when issued" trading to be regulated under the more general provisions of the preceding sentence.

We now come to the offering of debt securities. The Commission, in connection with proposed rule changes to provide for more simple prospectuses for use in the public distribution of high-grade so-called institutional type debt securities, is confronted with Section 305(c) of the Trust Indenture Act of 1939 which requires inclusion in the prospectus of the analysis of particular indenture provisions singled out by Section 305(a)(2) of the Trust Indenture Act. This requirement seems unnecessary in the light of the Commission's rule making authority under the Securities Act to deal with disclosure problems and the proposal leaves the matter to such authority.

The proposal does not affect the substantive provisions of the Trust Indenture Act which will continue to require that trust indentures contain the statutory provisions for protection of investors, for example, that there be independent indenture trustees with adequate resources and free of conflicting interests, who must report to security holders, and take other affirmative action to preserve investors' rights under indentures and to protect their interests in the event of default.

Finally, the bill provides for simplified registration procedure for investment companies. Investment companies which engage in continuous offerings of their shares, as a matter of practice, file new registration statements under the Securities Act of 1933 about once each year in order to have registered shares available. Section 6 of the Securities Act provides that securities may be registered by filing a registration statement but does not provide for registering additional securities by amendment. Section 403 of the proposed bill would amend Section 24 of the Investment Company Act by adding thereto a new subsection (e) which will permit such investment companies periodically to increase the number of shares registered under the Securities Act by amending their existing registration statements rather than by filing new registration statements. Paragraph (3) of this new subsection (e) will require that current information will be made a part of the registration statement and prospectus at appropriate intervals. There will be no departure from either the disclosure standards or the liabilities imposed upon sellers.

In view of this practice of continuous offering of securities by certain types of investment companies, particularly those commonly referred to as "mutual funds", a proposed amendment to the Investment Company Act would provide for mandatory use of prospectuses by dealers over a longer period than would be required under Section 4(1) of the Securities Act as modified by Section 7 of the bill. This provision appears in Section 402 of the proposed bill which amends Section 24(d)

of the Investment Company Act of 1940 by adding a further exclusion to those already contained in that subsection.

As previously noted, under existing law a dealer who is not a participant in the distribution need not use a prospectus in connection with a transaction in a security after the expiration of one year from the first date on which the security was bona fide offered to the public which, in most cases, means approximately one year after the effective date of the registration statement. Section 402 of the proposed bill would change this requirement by providing that a dealer, whether or not participating in the distribution, must use the prospectus as long as the issuer is offering any securities of the same class as the security which is the subject matter of the dealer's transaction.

I have limited my discussion tonight to the pending bill and have kept away from many proposals made by industry representatives during the course of the formulation of this legislation which were not made a part of it. Obviously, in an area so complicated and technical, and so important because of its impact on the raising of capital, not everyone's ideas would be the same. Also obviously I think, one must not expect the Federal securities laws, however well written and however well administered, to provide a panacea and cure for all the ills and risks inherent in the American free enterprise system. The basic purpose of these laws I think is that the investor shall have an opportunity to know the facts about what he is investing in. These laws do not insure against risk of loss. Insurance against risk of loss can only be provided by the fundamental soundness of the enterprise in which the investment is made. Under the American system the investor is allowed to choose, without interference by the national government, where he shall invest, and to me this is one of the great virtues of the free enterprise system in this country.