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FEDERAL REGULATION OF SECURITIES

Address of

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Commissioner,

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before the

DENVER CHAPTER

of the

INVESTMENT BANKERS ASSOCIATION OF AMERICA

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On August 10, 1954, President Eisenhower signed into law the Administration's bill to amend the Federal securities acts. The amendment (P.L. 577, 83d Cong., 2d Sess.) went into effect on October 10.

The bill had been passed unanimously in both the Senate and the House.

The act represents the first amendments of the securities acts in many years. Many previous efforts to improve the acts over the past thirteen years proved abortive. A year of intensive work by the Senate Banking and Currency Committee and the House Interstate and Foreign Commerce Committee, advised and assisted by the SEC, went into this legislation.

An important provision of the amended law will permit wider use of offering prospectuses for new issues of registered securities, particularly short-form summary prospectuses, during the so-called waiting period after the registration statement has been filed with the SEC but before it has become effective. Normally this period has averaged about 20 days. The SEC is presently studying the problems involved with a view to drafting rules to implent this provision of the new law. Information will be more readily available to the investor before he actually buys the securities. I will discuss this in more detail in a few minutes.

The amendments also permit greater use of newspaper advertisements during the waiting period. This should make it easier for small investors all over the country to invest in new issues of securities, whose distribution has up to now tended to be concentrated in a few cities having large capital markets.

Other provisions of the new law

(1) reduce from one year to 40 days after distribution of a new issue of securities has been commenced the period during which dealers must deliver prospectuses in trading transactions;

(2) simplify the information required in a prospectus used in an offering that lasts more than 13 months;

(3) reduce from six months to 30 days after distribution of a new issue has been completed the time when a dealer can extend a customer credit on the new securities;

(4) clarify the SEC's rule-making authority on "when-issued" trading;

(5) eliminate from prospectuses summaries of certain trust indenture provisions which have heretofore been required, thus permitting simplified, more readable prospectuses for debt issues; and

(6) provide simplified procedures for registration of securities of investment companies, the so-called "mutual funds."

I would like to discuss in a little more detail the amendment which I referred to a few moments ago designed to permit wider use of offering prospectuses for new issues of registered securities, particularly short-form summary prospectuses, during the waiting period. You have all been aware, I am sure, over the years of the apparent anomaly in permitting the distribution of "red herring" prospectuses, which purport to give information about the security to be offered but not to constitute an offer in the technical legal sense.

One of the original purposes of the Securities Act when it was framed in 1933 was to provide a period after the registration statement had been filed with the SEC and before it became effective during which prospective investors could become familiar with the pertinent facts relating to the issuer and the underwriting. It was in furtherance of this objective of disseminating information about the issuer and underwriter during the waiting period that the "red herring" prospectus mechanism and, more recently, the short-form identifying statement were devised. The 1954 amendment to the Federal law was intended to give a firmer statutory basis for this pre-effective dissemination of information and to give the Commission greater flexibility in permitting summaries and condensations of the pertinent material set forth in full in the Federal registration statement.

The amendment in no way affects the legal provisions which have existed up to now by which the full statutory prospectus must be furnished at the time the sale (as distinguished from the mere offer) is consummated.

I would like to stress, with as great an emphasis as I can put on it, the fact that the 1954 amendment does not permit the pre-effective use of sales literature which has not been filed with the Commission and processed by the staff. We have been disturbed in the past several weeks since the amendment became law because in several instances issuers and underwriters have sent out unprocessed sales literature prior to effectiveness.

The amended law was not intended to permit pre-effective "free writing." This was a subject briefed by industry representatives and thoroughly discussed with the Commission when we were serving as advisor and consultant to the Senate Banking and Currency Committee and the House Interstate and Foreign Commerce Committee in connection with formulation of the bill. The proposal of industry representatives that the Securities Act of 1933 be amended to permit pre-effective free writing was rejected. A study of the testimony given both by Chairman Demmler of our Commission and various representatives of industry groups will, I think, clearly reflect that there was no misunderstanding on the part either of the Commission or industry that pre-effective free writing was not intended to be permitted in the future any more than it has been in the past. (Hearings before a Subcommittee of the Committee on Banking and Currency, U. S. Senate, February 3 and 4, 1954, pp. 8, 31; Hearings before the Interstate and Foreign Commerce Committee, House of Representatives, March 19, 1954, pp. 24, 39, 52, 117.)

When the executive committee, the conference committee, the chairman of all the national committees, and the general counsel of the IBA met in Washington with the Commission on October 14, this was discussed and we are advised various industry representatives will submit suggestions in connection with our proposed rules to implement this provision of the amended law.

The Chairman of your Federal Legislation Committee asked whether the Commission would take administrative steps to assure that the short-form summary prospectuses intended for pre-effective use would be quickly processed by the staff so that they could be sent out to underwriters and dealers in the field promptly after filing. Such prompt administrative action on short-form prospectuses would contrast with the administrative handling of "red herrings" the examination of which by the staff has usually not been completed until the twelfth day in the 20-day registration period. We assured your committees that every effort will be made administratively to process the summary prospectuses promptly after filing. However, I think you should realize that the flow of business into our Division of Corporation Finance is not anything we can control, and our staff is limited in number. At some times each year, particularly from February through May, our staff is under time pressure because of the proxy season. However, our intentions in this regard are of the best as we are entirely in sympathy with the purpose of the amendment to foster broader dissemination of information about forthcoming issues during the waiting period.

As pointed out in the report of the Committee on Interstate and Foreign Commerce of the House of Representatives, the amendment will conform the statute to the present practice, encourage greater dissemination of information by relieving underwriters and dealers of fears connected with pre-effective distribution of written material, will make possible dissemination of more accurate information to the investor than he now generally receives, will not take away any of the protection heretofore afforded investors by the Securities Act of 1933, and will not change the liabilities for statements made or not made in the registration statement and prospectus. (House of Representatives, 83d Cong., 2d Sess., Report No. 1542).

Looking at these amendments from the standpoint of the State securities laws, we have made a careful study of possible conflicts with the State laws. Basically, our conviction is that to the extent "red herrings" and identifying statements were permissible under State legislation during the waiting period, there should be no difficulty in, and, indeed, the States in all likelihood should welcome, the use of the prospectuses and summary prospectuses which will be permissible under the revised Federal law.

It appears that 37 States have securities laws which provide for the registration of securities and prohibit both offers and sales prior to the effective date of registration. Notwithstanding the prohibition against pre-effective offers (as distinguished from sales) of securities, many State Securities Commissions have provided administratively for the dissemination of information prior to the effective date of registration.

To the extent that any problems may arise, it is hoped that they can be worked out through administrative cooperation without the States finding it necessary to amend their laws. I assure you that the SEC has every desire to, and will to the best of its ability, cooperate with State authorities in working out a practical solution of any problems which may arise in this field.

Before I close, if you will bear with me I want to mention one other matter in which the Commission and the IBA are both concerned. You will recall that the subject of the raising of equity capital for small business was considered by the Congress last year. A proposal to increase the exemptive amount under Section 3 (b) of the Securities Act from $300,000 to $500,000 was introduced, but deleted from the amending legislation before

it was finally enacted. The Small Business Administration is vitally concerned with this problem. The feeling has been expressed informally that many loan applications for comparatively small amounts of money should perhaps not be for loans at all, but rather what is needed is equity capital.

Recently, the Small Business Administration has established working liaison with the IBA and your Association has formed a Small Business Committee. At the SEC, we are cooperating with the Small Business Administration, hoping to use their facilities in over 200 offices of theirs throughout the country to distribute information about the techniques of preparing an offering circular and complying with Regulation A. We think these techniques should be as simple as possible, and we hope we can dispel the ignorance and fear that may exist around the country when anybody thinks of getting a small issue cleared with the SEC. Your cooperation, and that of the IBA in this area, will contribute greatly to the important process of capital formation in the field of small business.

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