AN ESTIMATE OF FEDERAL SECURITIES REGULATION

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As the appointed guardian of honest securities markets, the Securities and Exchange Commission is frequently in the bull's eye of criticism. Fault-finding of the independent regulatory agencies has recently become a popular business. The form of censure directed at this Commission is both varied and inconsistent. On the one hand, the Commission is blamed for doing too little, too late. On the other, it is condemned for doing too much, too soon.

Clarification of certain general misconceptions respecting the authority, functions and administration of the SEC should provide constructive results. It is important for the investing public, lawmakers and the press to have a reasonably accurate understanding of the extent of its jurisdiction and the nature of its problems in policing the nation's securities markets. Free-swinging, uninformed attacks on the SEC and the processes of capital formation can insidiously weaken investor confidence in the general integrity of the financial community. If public trust in American corporate enterprise and the investment banking industry is impaired, the growth and stability of the entire economy inevitably suffers. The abundant flow of individual savings into corporate investment is retarded. The public welfare would, therefore, be assisted by the presentation of a balanced, objective appraisal of the Commission's administration of the full disclosure concept embodied in the federal securities statutes.

The administration of these laws over the past quarter of a century is continuing to achieve three broad, constructive objectives: first, an ever-increasing quantity of reliable financial and business information concerning all forms of American trade and industry; second, constantly improving standards for accounting practice and corporate conduct; and third, an expanding sense of public responsibility by the securities industry.

These important accomplishments are, in large measure, the direct product of common-sense, vigorous enforcement of reasonable and necessary legislation. The Securities Act of 1933 and the Securities Exchange Act of 1934 do not represent extreme regulatory concepts. These are not oppressive statutes. Their effective administration, however, is indispensable for the protection of public investors.

In adopting a moderate approach to supervising the processes of capital formation and securities trading, the Congress, wisely, did not attempt to achieve the impossible. By these statutes, the Commission is not empowered to make investment decisions for the public. It does not pass upon the

merits, price or value of securities distributed or traded in the market place. It is not granted jurisdiction to regulate the internal operations of corporate management. It does not have the power to stop attempted acquisitions of corporate control through solicitation of proxies provided the contest is conducted in accordance with the Commission's proxy rules. It is not a collection agency for the benefit of victimized public investors. Finally, the registration and reporting requirements do not reach all types of securities, securities transactions or corporations.

To be fair and intelligible, critical evaluations of the Commission's operations should be based upon an understanding of the broad objectives of the securities statutes and the jurisdictional limitations imposed upon the Commission. The impact of alternative regulatory concepts should also be considered. For example, if the principle of disclosure is deemed to be ineffectual or inadequate, should the nation's investors be required to rely upon the judgment of expert security analysts in Washington for a determination of the investment merits and prices of securities? Should the multitude of decisions made by corporate managements be subjected to federal regulation? Should a federal agency be empowered to decide upon the qualifications of various groups fighting to control a corporation? Merely asking such questions suggests the imprudence of extending federal jurisdiction into these areas.

First, consider the charges that the Commission does too little, too late in protecting the investing public. The comment is frequently voiced that investors are fleeced and offenders have fled before the Commission takes effective action. To be fair, this type of criticism must be considered in the context of the characteristics of the securities market. Corporate securities, a readily negotiable commodity, as a general rule, are capable of being rapidly purchased and sold in the market place. Since they represent intangible interests in an enterprise, their intrinsic value is easily misunderstood or falsified. Violations of the securities laws unavoidably occur, simply and quickly, without advance notice to the Commission or to anybody else.

A market manipulation scheme might be so deftly designed and operated that the volume of trading and price fluctuations in a security may not be discernible until substantial damage has occurred. Then, once a manipulation is suspected by the Commission, the investigation, preparation and prosecution of the case usually requires extraordinary efforts over a long period of time. The identity of the principals, their agents and nominees, and their respective participations in the operation, have to be ascertained. Their transactions have to be traced through numerous brokerage firms and many different accounts. The size, volume, price, date and even time of the orders have to be tabulated from the records of the broker-dealers and carefully analyzed. Mere mention of these essential procedures illustrates the complex nature of the enforcement problems confronting the Commission in preparing a market manipulation case.

Similarly, investors may be injured by sales of unregistered securities through high pressure misrepresentations before knowledge of the attempted distribution reaches the Commission. The securities of domestic or Canadian companies may be washed through foreign intermediaries - such as Liechtenstein, Swiss, or Panamanian trusts - to numerous boiler rooms in a cunning attempt to conceal proposed distributions by an issuer or a controlling person. Illegal telephone and mail compaigns,which may commence without immediate perception by the Commission, cannot be stopped until the Commission is able to assemble sufficient evidence to support administrative or judicial action.

Untold volumes of securities transactions are effected each day in reliance upon some exemption from registration - such as trading transactions, private placements, intrastate offerings, or various types of exchanges of securities. The fluidity of the markets might well be destroyed and an oppressive administrative burden created if the law were to require advance clearance or advance notice of all of these types of exempt transactions. The Congress wisely placed the responsibility for establishing the availability of an exemption from registration with the person claiming it. The Commission takes prompt and effective enforcement action against offenders upon accumulating evidence of a violation of the registration requirements.

The maintenance of fair, honest and informed security markets is a herculean task. The fast-moving nature of securities trading precludes the feasibility of policing every single transaction. Since many financing arrangements incline to be intricate, enforcement problems are presented that defy quick solutions. Innocent victims of securities frauds are usually lulled into a false sensation of euphoria for months or even years. The Commission, usually, has neither advance notice nor prompt complaint of the perpetration of securities frauds. By contrast, the administrator of the pure food and drug laws may be dramatically alerted to a mislabelling violation if a consumer immediately dies after drinking a bottle of poison. The inherent characteristic of police work, in general, and of securities fraud enforcement, in particular, is that the presence of a cop on the beat prevents many violations that might occur, but crimes and derelictions of law inevitably happen and offenders can be sanctioned only after the damage is done.

The second type of criticism directed at the Commission is that it does too much, too soon. These charges are often based upon the theory that the Commission has misinterpreted or exceeded its powers, or that, for pragmatic reasons, the Commission should concentrate its enforcement efforts in other directions.

The statutory prohibitions against pre-filing offers of securities and the restrictions imposed on pre-effective offers have been occasionally misunderstood and violated. The Commission is continuing its efforts to clarify the strict limitations imposed by the explicit language in Section 5 of the Securities Act upon pre-filing and pre-effective free writing by

issuers and underwriters. An informative interpretative release on the subject of publication of information prior to or after the filing of a registration statement was issued in October 1957. In this release, the Commission took cognizance of the commendable and growing recognition by industry and the investment community of the importance of publicizing significant business and financial developments.

The Commission's policy is not, and should not be, directed at discouraging the trend towards greater publicity of reliable corporate information. The work being performed by the statistical and research departments of investment banking firms contributes greatly to the creation of informed investment opinion - a result which is identical to the objectives sought by the Commission in enforcing its registration and reporting requirements. Close factual and legal questions are often involved in determining whether particular publicity about a company constitutes lawful dissemination of information or an illegal offer to sell a security. The cardinal purpose of the Commission in enforcing Section 5 of the Securities Act is to prevent activities that are designed to stimulate, or have the effect of provoking, an interest in an offering of securities before all the material facts required by the statute to be disclosed to prospective investors respecting an offering are made available.

A precise delineation,by rule or statement of policy, of the permissible publication activities in the pre-filing or pre-effective period is probably impractical. Each case must rest on its own facts. Too many variable factors are involved. Some of these include the timing, content, method of circulating the information, who participated in its release and the reasonably anticipated public reaction to it.

Even a bare announcement by the issuer that it contemplates a public offering of securities at some future date might, under certain circumstances, be deemed an attempt or offer to dispose of a security. At the other extreme, a press release, issued either by a prospective issuer or its underwriter prior to the filing of a registration statement, which announces a proposed offering and describes some of its features, including the type of securities and their probable price, clearly constitutes, in the opinion of the Commission, an offer to sell in violation of the statute. The Commission does not, of course, consider that an offering of securities is involved where a company or members of the investment community publicly discuss in brochures, press releases, speeches or statistical studies, the present condition or future prospects of a company, provided the statements are unrelated to a contemplated public offering. However, if such information is disseminated by a company after it has decided to make a public offering in the foreseeable future or by dealers who know that they will participate in the offering, the Commission believes that the parties have engaged in an attempt to dispose of the securities.

Under the practices and customs governing the processes of securities distribution, the sensitive mechanism of selling can be initiated by the most apparently innocent announcements. Public statements about a proposed

offering made before the filing of a registration statement may excite the interest of the investment community - particularly, if the announcement discusses in glowing terms only the favorable features of the company. Brokers and dealers may seek immediately to become members of the underwriting or selling groups, and they may even attempt to obtain indications of interest from their customers. This chain reaction developing from pre-filing publicity destroys the protections afforded by the registration process. Members of the investment community and public investors may both be rushed into making commitments to purchase prior to having adequate information about the issuer and its securities.

In view of the proscriptions contained in Section 5, it is completely illogical to assume that the statute permits greater freedom to participants to disseminate information about a proposed public offering of securities in the period prior to the filing of a registration statement than after filing but before the statement has become effective. After a registration statement is filed, the statute is explicit that written offers to sell can only be made by using the preliminary and summary prospectuses or the tombstone advertisement. The issuer and its underwriters and dealers are not permitted to publicize the offering in any other form. During the pre-filing period - when not even a pre-effective registration statement is on file for public scrutiny - dealers and investors may be easily deceived by the publication of unexamined statements which are often designed to test or groom the market, or may have that effect.

Since unfettered free writing in both the pre-filing and pre-effective periods creates the precise opportunity for manipulation and high pressure selling that the securities laws were designed to prevent, the Commission must continue to pursue an unrelenting policy of vigorous enforcement against any form of gun-jumping. The antidote may take various forms. If the unlawful statements respecting the offering are predicated upon assumed facts respecting volume of sales or profits, the Commission may require the filing of up-to-the-minute certified financial statements before permitting the registration statement to become effective. Where the infractions have tended to influence the market price of the security, the Commission might deny acceleration of the effective date of the offering, in order to allow time for the effect of the unlawful activity to be dissipated.

Notwithstanding the views expressed by some members of the bar, the Commission is definitely acting in the public interest and within its statutory powers by denying acceleration in gun-jumping cases. Section 8(a) of the Securities Act, which invests the Commission with the discretion to accelerate an offering, provides, in part, that "the adequacy of the information respecting the issuer theretofore available to the public," as well as the criteria of public interest and investor protection, must be considered. There should be no reasonable grounds for questioning the validity of the proposition that information concerning an issuer is inadequate where the issuer or its underwriters have disseminated reports about a proposed offering which are imperfect by Securities Act standards. The filing of a registration statement subsequent to making an illegal announcement about

a prospective offering does not necessarily rectify the inadequacy of the information theretofore disseminated to the public. Nor, during the pre-effective period, is the effect of an illegal offering necessarily purged by the fact that a registration statement is on file.

A fair estimate of the federal powers to regulate securities transactions and their administration by the SEC is incomplete if merely limited to a discussion of the types of critical comments directed at the Commission - that it is doing too little, too late to protect investors adequately, or that it is doing too much, too soon. The policies that most effectively implement the attainment of the broad objectives of free, honest and informed securities markets should also be emphasized. These should include:

First, continuation of the vigilant and well-publicized program to achieve strict compliance with the registration and reporting requirements of the securities statutes.

Second, clarification of the impact of the registration provisions upon participants in a public offering of securities. The limitations of relying upon the intrastate exemption, the use of Rule 133, Section 3(a)(9) and investment letters, should be explained and stressed.

Third, acceleration of the expanding program of broker-dealer and investment company inspections.

Fourth, enlargement of the publicity campaign to warn innocent investors about the buccaneering schemes of boiler room operators, which tend to increase during periods of rising market activity.

Fifth, adoption of more expeditious procedures for detecting and investigating securities violations.

And sixth, augmentation of the tempo of criminal proceedings against the small but dangerous, lawless element in the financial community.

The Commission does not consider itself to be beyond the reach of justified criticism. Neither the federal securities laws nor their administration by the Commission is perfect. The Commission welcomes constructive criticism that assists its efforts to protect the investing public. For example, in performing its rule-making functions, the Commission has always solicited and carefully heeded public comments on its proposals. Likewise, when acting in its administrative capacity, the Commission has traditionally pursued the policy of freely discussing its interpretations with all interested persons. The purpose of this analysis is to attempt to demonstrate that the SEC is performing its complex duties vigorously, wisely and effectively.

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