ADDRESS

of

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before

NEW YORK FINANCIAL ADVERTISERS ASSOCIATION

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FINANCIAL ADVERTISING UNDER THE SECURITIES ACT OF 1933

Since September of 1935, when the former General Counsel of the Securities and Exchange Commission, Judge Burns, addressed the Financial Advertisers Association at Atlantic City on the subject of financial advertising, a lot of water has run under the bridge. The Commission has had the invaluable practical experience of almost two additional years of administering the Securities Act of 1933. You have likewise had the opportunity to become further familiar with the operation of this legislation and to arrive at a further understanding of the attitude of the Commission. In that time, all have come to recognize the sound purposes of the Act. In that time also, the financial community has acquired increased confidence in operating legitimately under the Act. The dissipation of the original fear of registration, which haunted Wall Street and LaSalle Street, is evidenced by the fact that during 1936 new security offerings having estimated total gross proceeds of over five billion dollars were registered. There remains the problem of dissipating a reluctance which survives in certain quarters to adequate publicizing of security issues. This is a matter of common interest to the Securities and Exchange Commission and to you who are here. To a discussion of this problem the bulk of my remarks will therefore be addressed. In this discussion I shall endeavor to bring out, not the prohibitions which are a necessary part of any regulatory statute such as the Securities Act, but rather the nature of the publicity which may lawfully be afforded under its provisions.

All of you are familiar with the purpose and scope of the Securities Act, and I need not state more than that primarily it represents a requirement of full disclosure in registration statements and prospectuses of material factors affording a basis for the appraisal of new issues of securities. Except in the case of redistribution of securities by a person affiliated with the original issuer, the registration and prospectus requirements of the Act through which such disclosure is brought about do not apply to trading in outstanding securities after the process of distribution has been completed. Supplementing this Act, as you know, is the Securities Exchange Act of 1934, which is concerned primarily with the regulation of trading in outstanding securities both on established exchanges and in the over-the-counter markets. Since financial advertising is not substantially affected by the Exchange Act, references to that Act will generally be incidental.

It seems to me that financial advertising may, roughly speaking, be broken down into three general classifications: corporate notices; dealer advertising; and securities advertising.

The registration and prospectus requirements of the Securities Act only come into play if an offering or sale of securities is involved. Consequently, although the term "sale" is broadly defined in the Act to include not only the execution of a transaction of sale, but also every attempt to dispose of a security, it is obvious that the usual form of notice addressed by a corporation to its stockholders, such as notices of dividends or meetings, calls for redemption of outstanding securities, notices given by a fiscal agent calling for tenders, and other similar notices, do not come within the ambit of the Act.

Proxy solicitation by means of advertising, whether effected by the company or by an independent committee, is a form of financial advertising which, so far as the Securities Act is concerned, is in the same category as are corporate notices. If the security whose holders are solicited is listed on a securities exchange, the disclosure requirements of the proxy regulations promulgated under the Exchange Act should be observed; and if the issuer of that security is a registered holding company or a subsidiary of such a company, it may be appropriate to consider the requirements of the Public Utility Holding Company Act. However, I believe that in the present discussion it will be more advantageous to confine our attention to the major questions of advertising which are presented under the Securities Act. There is another type of notice which, at first blush, appears to have certain attributes of the corporate notice and of the proxy solicitation. I refer to the advertisement of a committee which thereby solicits the deposit of securities. Such a committee is in effect offering its certificates of deposit in exchange for the deposited securities. These certificates of deposit, except for a few specified types of securities, are therefore subject to registration under the Securities Act, and advertisements soliciting deposits are subject to the same requirements as any other published offer of securities for sale.

A second form of financial advertising, already mentioned, which I believe deserves brief comment, is what I have termed "dealer advertising". As a result of the operation of the Securities Act, there is now available a fund of pertinent information relating to new security issues which should be hailed as a bonanza by the security dealer who pretends to be more than a peddler and the investment counselor who pretends to be more than a quack.

Such a security dealer or investment counselor, by using information which in the past was too frequently concealed even from the banker, may now build his business reputation on the rock of solid fact. In seeking to establish and maintain an enviable business reputation, the dealer should not overlook the opportunity which institutional advertising affords him to bring before the public the service which he stands ready to render. Such advertising, when it is not related to a particular security, falls outside the ambit of the Securities Act, and represents what appears to me to be a field the possibilities of which have only been partially explored.

We cannot discuss securities advertising without briefly laying certain groundwork based upon the substantive provisions of the Securities Act. If a security is one which is exempt from registration, the advertiser need concern himself only with that provision of the Act which required that his advertisement be not misleading. You are all familiar with the various classes of securities which are exempt from registration, such as governmental and municipal obligations, securities of building and loan associations and charitable institutions, issues of common and contract carriers approved by the Interstate Commerce Commission, securities issued in certain types of reorganizations, and securities distributed wholly to investors residing in the same state in which the issuer is incorporated and doing business. The same lack of restriction upon the form of securities advertising obtains where, even though a security is not itself exempt, the offering of the security involves a proposed transaction which is exempt. In general, it may be said that all transactions which involve merely trading in securities, as distinguished from the distribution of securities, are exempt from registration and accordingly from the prospectus requirements of the Act.

To achieve this result, the Act has exempted transactions by persons who are not issuers, underwriters, or security brokers or dealers. It has similarly exempted transactions by an issuer which do not involve a public offering. Most important, however, from the standpoint of the security dealer and the advertising agency is the exemption afforded to transactions by dealers which are not connected in time or circumstance with the original or secondary distribution of securities.

The effect of this so-called dealer exemption is that, even though an issue is not exempt, an advertisement of this issue by a broker or a dealer is not subject to the prospectus requirements if more than one year has elapsed since the first date upon which the issue was offered to the public and if the securities offered are not a remnant of the dealer's allotment as a participant in the original distribution. This exemption, of course, extends to registered as well as unregistered securities. Consequently, an advertisement by a dealer no longer participating in the distribution of the securities advertised, which is published more than one year after their public offering, is not restricted as to form or content, even though the security be registered. If, however, an advertisement relating to a registered security is published by a dealer within the first year after its public offering, or if the security advertised is part of the dealer's allotment as a participant in its distribution, the prospectus requirements must be observed. It makes little difference whether the advertiser proposes to act as a broker or dealer in effecting transactions in the security advertised. The Act exempts unsolicited brokerage transactions, but since the advertisement of a broker as to a particular security can hardly fail to be a solicitation, this exemption will not operate to broaden that afforded to dealers generally.

In addition to the dealer exemption there is another important exempting provision of the Act which permits unrestricted publication of the so-called "tombstone" or short-form advertisement. An advertisement of a security which affirmatively states from whom the full offering prospectus may be obtained is not subject to the prospectus requirements, provided that it does no more than identify the security, state the offering price, and state by whom orders will be executed. You will note the one affirmative requirement in connection with the short-form advertisement, namely, that it must state from whom a copy of the full offering prospectus may be obtained. The negative requirements that the advertisement shall do no more than state the name of the security, the price at which offered, and the person from whom it may be purchased, must of course also be strictly observed. Naturally, the inclusion of any reference to the merits of the securities advertised, or of any description of the business or financial condition of the issuing corporation, or any other form of selling talk, will exceed the permitted limits.

I might point out in this connection, however, that a broker or dealer may, without becoming subject to the prospectus requirements, publish a list of securities which he is offering, even though some of the securities listed are issues which have been registered and publicly offered within the year preceding the advertisement and are therefore not entitled to the dealers' exemption. However, if the list does contain some such issues, the advertisement must affirmatively state that a prospectus for these securities is available. This may conveniently be done by putting an asterisk after the names of such issues and inserting a single line at the bottom of the advertisement to the effect that a prospectus for these

securities may be obtained from the advertiser. Furthermore, the information given in such an advertisement listing a number of securities must, in so far as it concerns the registered securities offered within a year, be limited to a bare statement of the price at which such securities are offered.

In order to comply with the prospectus requirements, any advertisement other than a short-form "tombstone" notice must either consist of a reprint of the full offering prospectus, or, if the security advertised is registered upon Form A-2, it must comply with the rules governing newspaper and periodical prospectuses for such securities. The expense of printing the whole offering prospectus as a newspaper advertisement is of course prohibitive. Consequently, as a practical matter, the only securities advertisement which may be published, other than the "tombstone" notice, is the so-called long-form advertisement or newspaper prospectus.

Two years ago Judge Burns in his address at Atlantic City described the newspaper prospectus and expressed the hope that it would prove a practicable means of stimulating the adequate advertising of new issues. As you may remember, the rules governing this "long-form" advertisement were worked out with the very real assistance of representatives of the leading financial advertisers and advertising media. The objective was an advertisement of approximately one-quarter of a page of standard news print which would give the investor a reasonably complete sketch of the business for which his money would be sought. Mr. Harold H. Neff, Director of the Forms and Regulations Division of the Commission, supervised the study and analysis on which was based the ultimate determination by the Commission of the matter to be included in these advertisements.

Accordingly, I should be trespassing considerably beyond my sphere were I to discuss the considerations of policy which prompted the inclusion of those particular items called for by the Commission's regulations. It is unnecessary for me to summarize the required items of information, for you are all familiar with the general set-up and form of the newspaper prospectus. This type of advertisement I am glad to say has not only proved to be workable but has served a public purpose in putting before prospective investors in compact form some of the more pertinent facts bearing on the security offered. Within the past year one of the most regular adherents of the "long-form" advertisement has used it to advertise some fourteen issues aggregating more than eight hundred million dollars in offering price. A number of other originating underwriters have also made occasional use of this form of advertising.

When provision was made for newspaper prospectuses in 1935, it was the thought of the Commission that offerings of substantial size could well be publicized through this medium; and at that time the desirability from all points of view of the use of the long-form advertisement was suggested to the investment banking community. It was felt that the use of this prospectus could aid in the achievement of a primary objective of the Securities Act - the dissemination of information - and could further the legitimate function of the underwriter.

Of course, all new issues in which there is any appreciable public interest are announced at least through so-called "tombstone" advertisements. But these give the investor practically no facts on which he can intelligently determine whether the security may be adapted to his individual needs. On the other hand, the newspaper prospectus does contain genuinely illuminating material for the guidance of the individual investor and may have real advantages to the house of issue beyond the immediate

disposition of the advertised security. Experience has demonstrated that this type of advertising is practical, may be readily prepared, and does not require excessive space.

As I understand it, the customary objection to the long-form advertisement is that it may in some way increase the potential liability of underwriters. It is suggested that in summarizing information there is a risk of omitting data, the absence of which may make the contents of the advertisement affirmatively misleading. Let us look at this asserted fear of misleading summaries and the spectre of augmented liability. I submit that this potential liability, at least so far as it is based upon a newspaper prospectus, may be so reduced by the exercise of reasonable care as to become practically negligible.

In the first place, the rules governing a newspaper prospectus require the inclusion of only a restricted number of the items as to which information is contained in the offering prospectus. Furthermore, the information which must be contained in the offering prospectus is, on the whole, readily susceptible of condensation or of transfer *in toto* from the text of the offering prospectus itself. A summary of the issuer's capitalization, a statement of the purpose of the issue, a disclosure as to whether or not there is a firm underwriting commitment and what the spread or commission is, are matters of plain fact which may be set forth with brevity and directness. The other principal items which must be included in the newspaper prospectus, namely, a statement as to general type of the issuer's business and a description of the securities offered, are matters which corporate lawyers have long been accustomed to summarize in offering circulars. In other words, it would appear that whatever risk is involved in the process of condensation is a risk which is primarily inherent in the preparation of the offering prospectus itself.

In the second place, the risk of liability arising from summarization is one which existed long before the Securities Act. Prior to 1933 it was never regarded as presenting an insuperable obstacle to the advertisement of new security issues. Furthermore, the present-day underwriter has the advantage of increased legal responsibility on the part of the officers and directors of the issuer, and accountants, engineers and other experts, which in consequence gives him greater assurance that he is correctly informed as to the data on which the offering prospectus and the summarized advertisement are based.

Finally, bear in mind that there can be no liability for the omission of information unless it is specifically required by the rules governing the newspaper prospectus, or unless the prospectus, to quote the language of the statute,

> "omits to state a material fact necessary in order to make the statements *in the light of the circumstances under which they were made*, not misleading . . .".

The rules are explicit and, if they be followed, liability can arise only from an omission which gives rise to a "half-truth". Furthermore, if, in the condensation of certain complex material, the underwriter has concern lest some inadvertent and apparently minor omission may possibly render some particular portion of the advertisement misleading, he can fairly protect both himself and the public by expressly stating that the information given is summarized and omits certain further facts set forth in the offering prospectus, which is available to each prospective purchaser and should be examined by him before any purchase is made. The purchaser can thus be put on full notice of the abbreviated character of any statement in the advertisement. In addition, the rules themselves require that the Newspaper Prospectus state that further information is contained in the registration statement on file with the Commission, and in the offering prospectus which must be furnished to each purchaser.

A further objection which I understand is made to the use of a newspaper prospectus is that it has not been worth while to resort to this type of advertising up to the present time. Possibly that may be true. It must be admitted that the newspaper prospectus involves some additional cost, primarily in the purchase of space and to a slight degree in the added technical work which its preparation involves. However, it seems to me that the long-form advertisement, standing out as it does on the financial page, has a quality which catches and holds the attention of the reader.

Now you may suspect that, as a lawyer and not an avertising man, I am prejudiced in favor of this form of advertising because of the fact that it is normally prepared, or at least edited, by a member of my own profession. Discounting any such bias as far as I can, I believe that my liking for the long-form advertisement arises because it affords me a valuable concise picture of the proposed offering. It is, of course, for you to determine the type of advertising which is best adapted to the needs of the particular offering. However, I venture to suggest that you consider whether, even if the long-form advertisement is not strictly necessary, it nevertheless may not offer the opportunity for increased institutional prestige—valuable not only to the individual firms who utilize it but to the underwriting business as a whole. In short, past consideration by underwriters of the value of the long-form advertisement may well have given too little attention to the possibility that its admittedly greater cost will in the long run represent a sound investment.

Let me repeat that publicity is the keystone of the Securities Act, fair publicity, adequate, under the circumstances of its use, in scope and in detail. The newspaper prospectus is just as much an expression of this fundamental objective as is the registration statement or the full offering prospectus. In a true sense it gives the investor an introduction to the basic information of the prospectus, and affords him an opportunity to decide whether he wants to look further into the issue and thereupon make his final decision as to whether to buy.

In these remarks I have endeavored to review in rather summary fashion various aspects of the Securities Act as it relates to financial advertising. In concluding I can only repeat that your activities and those of the Commission are not only allied, but are directed to a single common purpose--the honest and adequate presentation to the prospective investor of the facts essential to intelligent investment judgment. In the achievement of this purpose, it is my hope that you who are represented here, and the Commission, may work together in the future as we have in the past.

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