NEWS

SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549
(202) 755-4846

FOR ADVANCE at 4:00 P.M., Tuesday, August 15, 1972

An Address by

William J. Casey, Chairman

Securities and Exchange Commission

August 15, 1972

AMERICAN BAR ASSOCIATION
Section of Corporation,
Banking and Business
Law
Mark Hopkins Hotel
San Francisco, California

I am very pleased to be here in San Francisco at this 95th Annual Meeting of the American Bar Association and to have the privilege of speaking to the annual luncheon and business meeting of the section of Corporation Banking and Business Law.

I don't have to stress to this audience the degree to which the Commission's task of regulating the market and maintaining fairness in securities dealings depends upon the work you do in your office and the guidance you give your clients. We're all aware of the extent to which the needs and demands of a more sophisticated and involved investment public in an increasingly complex economy has resulted in action by the Commission and the courts to place heavier burdens and responsibilities on you and your clients. We want you to know that we are sensitive to this and that we recognize our obligation to make as clear and definite as possible the rules and standards to which the business and professional community will be held.

One of the Commission's major efforts this year is to complete the task of creating greater clarity and certainty in

the rules governing the sale of securities. We plan to accomplish this through Rule 144 and 145, already promulgated, and Rule 146 and 147, which are now a little more than a gleam in our eye, with perhaps a little preliminary drafting. I would like to discuss these rules with you today as far as I am able to at this time.

We have now had four months of experience with Rule 144. This has been a shakeout period during which we have had an opportunity to see how the rule works in practice. Requests for no action letters have fallen off considerably. We are working with brokers and underwriters and transfer agents, as well as the Bar, to streamline and simplify procedures in implementing Rule 144. We hope to be able to cut costs and paperwork. Next month we intend to publish a summarization and collation of all the interpretative positions that have thus far been called for and been taken in the administration of Rule 144. We plan to extend this process of summarizing and collating the staff's interpretative positions to other areas of interest to the Bar and to do this on a continuous basis.

We have had a large number of comments on the abolition of old Rule 133 and its replacement by Rule 145. Our purpose was to rid the securities laws of the old shibboleth about "no sale" but to provide for simpler registration of securities issued in mergers and acquisitions. We have received 370 pages of comment from 52 sources. Most of the comments have centered upon the resale provisions, which many people thought would unnecessarily tie up merger stock. We hope to have a final Rule 145 ready by the end of September, and I believe that the changes we are making in the resale provisions, which will essentially leave free stock in the hands of all but the holders of control of the old or new corporation, will satisfy most of the complaints.

Rule 146 is designed to provide greater certainty as to when a private offering exemption is available. We are working hard to get this rule in shape to be published for comment during the month of September. Let me tell you something about the concept of Rule 146 as we now see it. It would be strongly non-exclusive. It would carve out a set of standards which, if met, would qualify for the private offering exemption, as the rule would define it. An offering would be deemed to qualify if all the conditions of the rule are met. One condition would deal with the manner of offer. Its major requirement would be the absence of general advertising, together with a negotiated transaction in which someone represented each buyer. Another element would be a numerical limitation on the buyers. The number is not fixed but 35 is not unreasonable. That is the figure used by Professor Loss and his associates in the American Law Institute's codification project. It is also a figure used in proposed legislation regulating oil and gas

offerings which the Congress requested the Commission to submit. Over and above the numerical limitation, a private offering could also include those who purchase for cash in a substantial amount, which might be $50,000 or $100,000. This will be the counterpart of the provision of the ALI codification project which would exclude from its numerical limitations institutional buyers. In our present thinking, we are using a dollar amount which avoids the complex task of defining an institution.

Another condition would involve access. That one is not easy. Our present thinking is that the access of an advisor or representative of a buyer would be imputed to the buyer and that there would be a contractual commitment to provide continued access to information about the affairs of the issuer. A further condition would apply a suitability test offering assurance that the buyer is a type of person who does not need the protection of registration based on his financial circumstances and his ability or that of his representative to comprehend the deal.

Rule 147 will undertake to develop objective standards for the intrastate exemption. That exemption was intended to facilitate the local financing of local ventures. This rule will seek to define the meaning of doing business within the state in terms of how the origin or location of revenues, earnings, and assets bear on this question. It will undertake to define objective standards for determining where the proceeds are being used, when the security comes to rest and how long it has to be held in order to be deemed to have come to rest.

If I had to sum it up in a phrase the task in which the Commission and the bar have a common interest and a common task, I would say it is to assure the integrity of our securities markets. The vitality of a priceless national asset, the best capital market in the world, depends not only on our doing that task well but also on the public perception that the fairness and the integrity of our securities markets have indeed been maintained.

Today, I would like to review with you the strategy and the multiple efforts which the Commission is employing to perform its part of this mission. We deal on a day to day basis with hard core frauds and market manipulations and we seek to eliminate this kind of pollution by throwing the rascals out of the business. At another level, we deal with trading on inside information, false publicity and misleading information about the performance and prospects of a company.

At still another level, we undertake to require precision and responsibility in the reporting of performance, progress and problems. This has the direct value of informing investors and their advisors and the very great and frequently overlooked value of influencing care and responsibility in the conduct of business. Disclosure may be more beneficial in how it leads men to perform than in what it discloses.

Now, what strategies do we have for dealing with these varying levels of infection which can undermine the integrity of the securities markets?

Preventing the unfair use of inside information is a particularly difficult task but we have come a long way in controlling the abuse of inside information. Our securities laws now take into account the fact that most transactions do not take place face-to-face but are handled over the telephone and through the mails and the impersonal mechanisms of the marketplace.

The strategy is quite simple. Together with the self-regulatory agencies we do conduct a continuous surveillance of trading activity. We do have computer programs which flag the issues in which there is a sharp increase in volume accompanied by a price change which seems unusual. If significant news subsequently comes out on that company, and sometimes even if it does not, investigation may be indicated. But other pressures operate even more effectively than this kind of surveillance to bring about prompt public dissemination of developments significant to the value of securities. Insiders who have this information are unable to trade safely until disclosure is made. Analysts and others to whom inside information becomes available can't use it

safely. They are muzzled until public dissemination is made. Thus, we have reached a point where the public can have the assurance that it is in the interest of both company officials and professionals to see that new material corporate developments are promptly disclosed. Material inside information is a hot potato which freezes the company, its officials and advisors and both muzzles and freezes analysts and other professionals who get it ahead of the pack.

In much the same way making the disclosure process more sensitive not only provides critical information to which investors and their advisors are entitled but also, and perhaps more importantly, serves to focus managerial attention, judgment and responsibility on the performance, progress and problems of the enterprise. It elicits responsibility to the extent that disclosure calls for an expression of judgment on business objectives and plans and obstacles to their achievement. This kind of responsibility is blurred if not nulified by the kind of language lawyers have developed to convert a prospectus from a business communication between issuer and investor into an insurance policy against potential liability.

We have just made a major revision of the Commission's organization structure. They tell me it's the most sweeping reorganization since 1942 but it's really quite simple. All disclosure is now concentrated in a division, all enforcement in another and two new divisions have been spun off, one to regulate trading, markets and exchanges, the other to regulate investment companies and investment advisers. The purpose of this reorganization is also quite simple. I expect it to concentrate and focus our best talent on our major objectives under the leadership of our most proven executives each concentrating on that area in which he has the greatest experience and each charged with developing the next generation of leadership in disclosure, in enforcement, in market regulation, in money management regulation and in our holding company and reorganization functions.

I also expect the consolidation of functions to yield efficiencies which will give us time and manpower to refine and improve our disclosure activities. We have learned to process a great many more registration statements more

quickly by relying more heavily on the work of issuers and underwriters and the lawyers who represent them. Our Chief Accountant, with a somewhat expanded staff he will have, and a special analytical staff in the Division of Corporation Finance will be continuously seeking to refine our financial reporting and disclosure requirements to make them more sensitive and more suprise proof. Certainly new venture prospectuses have been frightfully inadequate when compared with the kind of information a knowledgeable venture capitalist would demand before he let a new company in the door.

Our financial reporting requirements must do a better job of bringing out the factors necessary to form a judgment on the viability of an issuer. Sudden and suprise awareness that a company is running out of money, as in the case of Penn Central, is both unnecessary and unnecessarily damaging to confidence in American capital markets. As a starter, we are examining stiffer disclosure requirements on debt maturities and contractual commitments. In a related area,

the London Economist pointed out a few weeks ago that this is the year of the big bath for corporations. There will be 2 billion dollars of supercharge-off this year ranging from 50 million or so to a quarter of a billion. Some of these superlosses are inherently sudden in their appearance like expropriation by a foreign government. Others come suddenly but seem predictable in the light of hindsight like giving up on a losing business. Still others come when hope is abandoned on an accumulation of expenditures for future benefit, research and development being the most common example. A strengthened Chief Accountant's staff and a special analytical unit in the Division of Corporation Finance will be examining ways to spot light the potential for this kind of big bath and the factual and judgmental bases on which major outlays are carried forward or charged off.

One the early results of the transfer of investment company disclosure processing to the Division of Corporation Finance, will be the application of the improvements which have been made processing 1933 Act registrations to investment company offerings. There will be an immediate effort

to make investment offering circulars more readable, to encourage greater use of summaries, to make greater use of guidelines. On the other hand, boilerplate language is more likely to be challenged. There will be an immediate effort to integrate the requirements of the 1933 and 1940 Acts in much the same way as over the last few years there has been an effort to integrate the informational requirements of the 1933 and 1934 Acts.

Another major purpose of our reorganization is to place greater emphasis on regulation and adherence to rules. To accomplish this we must provide workable and comprehensible guidelines to let you and your lients know what standards of conduct we believe are applicable. One area in which such a satisfactory set of ground rules is sorely needed is insider trading. While it is true that certain key elements in this area of the law do not lend themselves to precise definition -- the concept of materiality is a good example -- I feel we have a duty to try to provide more definitive guidance where possible.

For example, we are attempting to develop some standard as to the proper treatment of "market" information -- that is, information not about the business of the issuer but about the market for its securities. Do the rules governing insider trading pertain when a seller knows another holder is about to sell a block which is likely to have a significant market impact? Do they apply when one knows or has reason to believe that a highly regarded analyst with a large following is about to change his opinion on a particular issue or that a respected columnist is about to boost or torpedo a stock.

On a more basic level, what specific steps should an institutional salesman or an analyst be required to take when he becomes aware of certain corporate information for the first time? How can he determine whether the information is already public or, if it is about to be released, when it will be deemed to be sufficiently disseminated?

Perhaps it is even time to take another look at the underlying system by which those who "market" analytical information about a company are rewarded for their services.

Does a structure under which those who provide useful research to institutional investors are compensated by direct allocation of commission dollars necessarily lead to a derby in which non-public corporate information is more highly sought after than fundamental analysis?

I believe you are entitled to know our answers to these questions, and attempting to provide you with them will be a matter of high priority at the Commission.

The trading rules under Section 10(b) of the '34 Act present another area in which regulation can play a strong role by helping to codify the existing body of interpretive practice. Unfortunately, weaving one's way through the existing rules has become an occult art, demanding more knowledge of lore than law.

A good starting point would be to re-examine the question of when a distribution is taking place, particularly in view of the evolution of methods of trading not contemplated when rules such as 10b-6 were written. It may also be appropriate for the Commission to consider promulgating a set of criteria to govern permissible market activity along lines specifically

adapted to the normal techniques involved in the handling of block transactions while at the same time guarding against the abuses which make the Rule necessary. The Commission's Advisory Committee on Block Trading has recently recommended just such a re-evaluation.

In the same vein, Rule 10b-2 undoubtedly merits a careful revisiting to determine whether it is still serving the purposes it was intended to serve, particularly in light of current interpretations and applications.

Generally speaking, what is needed in this area is a common sense reconciliation of two objectives: the need to prevent manipulative activity during a distribution of securities and the equally compelling need to encourage maximum liquidity in the disposition and handling of large blocks.

In conclusion, I would like to assure you that the Commission is acutely aware that in our efforts to improve disclosure, eliminate the abuse of inside information, and to enforce the other obligations of the securities laws, we are engaged in a very delicate operation. Pushing too hard may tend to dry up what is on the whole a good flow of information. Enforcement and potential liability can be self-

defeating if it is so capricious and so unpredictable and so heavy as to induce good men to shun responsibility. That is why we have been reviewing our enforcement procedures. That is why, in our new organizational structure, we have strengthened the responsibility and the ability to promulgate rules so that people will know what their responsibilities are. That is why we have asked Al Sommer and his committee to study and provide us with recommendations as to how our rules might be modified to make liability more predictable and make the combination of good faith and diligent effort provide greater assurance. That is why we applaud and await with great interest the efforts of Louis Loss and his fellow codifiers to redefine the basis for and the measure of civil liability in securities transactions. That is why we solicit your help and interest and extend ours in our mutual efforts to maintain the integrity of the American securities market.