NEWS
SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549
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SAVINGS AND LOAN ASSOCIATIONS AND THE SEC

An Address By

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Securities and Exchange Commission

July 9, 1974

UNITED STATES LEAGUE
OF SAVINGS ASSOCIATIONS

The Palmer House
Chicago, Illinois

This is the third time I have had the pleasure of talking to lawyers of the United States League of Savings Associations. In Miami Beach, in 1964, you asked me to talk about the duties of association directors. In 1970, in San Francisco, at your request the subject was debenture financing. For today, Bill Prather suggested that I talk about the several ways in which savings and loan associations may become involved with the Federal securities laws and, he said, "Keep it technical and meaty".

I thought you would like to know what Bill is doing to you.

You will notice that he has never asked me to talk about the central legal problems of savings and loans. Bill knows that I don't know much about that and probably never will. But I do know something about some of the peripheral legal problems encountered by this industry.

The Securities Act of 1933 and the Securities Exchange Act of 1934 were enacted at a time when the corporate identification and area of activity of our several classes of financial institutions were pretty clear. Commercial banks, insurance companies and savings associations had fairly discreet lines of business, and, in general, except for the fraud provisions, Congress intended to exempt the securities of such institutions from the reach of the '33 Act -- the one that requires the registration of securities prior to a public offering and the delivery of a statutory prospectus.

Congress's reasoning in the way this was done is not entirely clear. For example, one can understand exempting savings and checking accounts, members accounts and insurance policies, on the ground that other regulatory agencies and laws, state and federal, are devoted to protecting depositors, members and policyholders, and the disclosures required by '33 Act registration are superfluous. But how can you say this about bank or association capital stock? And yet not say it with respect to insurance company stock? If the difference was some degree of control by the regulatory agencies over all issues of securities by banks and associations but not by insurers, one can see a basis for it, although this distinction has not been adhered to for other regulated industries, and the other regulation is presumably not devoted to investor protection.

It has been observed, in any event, that when Congress exempted from the '33 Act all securities issued by banks, it had a fairly concrete idea of what it was exempting. Does this lead to the conclusion that, despite the clear language of the statute, Congress exempted only the types of securities being issued in 1933? This has not been the regulatory or judicial approach to date, and yet the basing of the exemption upon the classification of issuer is, to me, intellectually and practically unsatisfying, and the more so as the situation becomes more complex.

We can see how the present system works by looking at the pending Citicorp offering of floating rate notes -- a proposed financing that has attracted much association attention for less technical reasons.

If the notes were being issued by Citibank, a national bank, instead of by Citicorp, its non-bank parent, other regulatory problems would no doubt be raised, but there would be a clear exemption from '33 Act registration: What difference would that make?

Not having to register under the '33 Act would, first of all, save the $170,000 filing fee paid on the aggregate principal amount of the $850 million proposed offering.

It would free Citicorp from having to comply with our Form S-7 and wait for and receive staff comments.

The peculiarly stringent liabilities created by Section 11 of the Act would not apply.

These things are worth being exempted from, if possible, from an issuer's point of view, and yet it is also possible to exaggerate the significance of exemption. The offering would in any event have been subject to the general antifraud provisions of Section 17(a) of the '33 Act and Section 10(b) and Rule 10b-5 of the Securities Exchange Act of 1934. Consequently, this would be a strong incentive on the part of all persons involved in preparing the offering circular to make it true and complete. Because of this and other features of the offering, an exempt offering circular would probably very closely resemble the statutory prospectus included in the registration statement.

What happens to a registration statement on a Form S-7 that is filed with the SEC under the '33 Act? The securities being registered cannot be sold until the registration statement becomes effective, and if you look at the language of the Act, you will conclude that the registration statement will become effective 20 days after filing unless the Commission begins a stop order proceeding or unless the registrant files an amendment, which starts a new 20-day period running . From the earliest days, it has not really worked that way. At the very beginning, the staff of the Commission decided that it would furnish registrants with comments, pointing out apparent deficiencies in the filed material, rather than start formal stop order proceedings -- except in egregious cases. On their side, registrants decided it was wiser to forego becoming effective until staff comments were received and responded to, hence the delaying amendments, now accomplished by a legend on the facing sheet of the registration statement.

When the staff's comments have all been taken care of, one way or another, the registrant does not want to have to wait for 20 days from his last amendment, especially if, as is usually the case, the price to the public and related terms are sensitive to market changes. To be able to go to market as promptly as possible after all disclosure problems have been settled and the deal priced, the registrant requests an order in effect accelerating the effectiveness of the registration statement. The authority to issue orders of acceleration has been delegated to the Division of Corporation Finance. The Director of the Division may consult the Commission when he thinks it wise. Otherwise, the Division acts on its own judgment in accordance with the policy set forth in the Note to Rule 460 of the Rules under the '33 Act.

The Note to Rule 460 says that, "Having due regard to the adequacy of information respecting the issuer theretofore available to the public, to the facility with which the nature of the securities to be registered, their relationship to the capital structure of the issuer and the rights of the holders thereof can be understood, and to the public interest and the protection of investors, as provided in Section 8(a) of the Act" once the amendment correcting deficiencies and fixing prices is filed, then the Commission will grant acceleration virtually as a matter of course unless, for example --

> there is no undertaking re: indemnification of underwriters, directors and officers for Section 11 liabilities;
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> there is a pending Commission investigation;
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> underwriters don't meet the net capital rule; or
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> there have been manipulative transactions by insiders.

The Citicorp registration is now in the middle of this process. We have received earnest pleas from persons connected with competitive thrift institutions urging us to use the '33 Act procedures to delay the offering. It is our present view that we should adhere to the policy set forth in the Note to Rule 460, which we think is consistent with the intent of Congress in the

Act. We have not used the authority and practical leverage intended to stimulate the production of full and fair disclosure for other and unrelated policy purposes, and we don't think we should begin to do so.

Among other considerations, we are concerned with the negative implications of doing otherwise. Whoever ultimately has the better of the argument with respect to the desirability of floating rate notes issued by bank holding companies, we do not want to create a basis for any investor, or any one else, drawing any conclusions on our views of the merits of such notes from the fact that we let them be sold. Ever since 1933, the Commission has tried to get investors and citizens at large to understand that the fact that the Commission permits a registration statement to become effective by lapse of time, or declares it effective by order of acceleration, and thus permits the lawful public offer and sale of the registered securities -- that none of this means anything about the merits of the securities or, indeed, about whether the offering is good or bad for our economy, fiscal policy, etc. I would be opposed to our now starting down that road of relating effectiveness under the '33 Act with other policy considerations, however worthy.

Now, let me return from this long digression and get back to savings and loans and the securities laws.

Focusing still on the Securities Act of 1933, Section 3(a)(5) provides:

> "Sec. 3(a) Except as hereinafter expressly provided, the provisions of this title shall not apply to any of the following classes of securities:
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> (5) Any security issued (A) by a savings and loan association, building and loan association, cooperative bank, homestead association, or similar institution, which is supervised and examined by State or Federal authority having supervision over any such institution, except that the foregoing exemption shall not apply with respect to any such security where the issuer takes from the total amount paid or deposited by the purchaser, by way of any fee, cash value or other device whatsoever, either upon termination of the investment at maturity or before maturity, an aggregate amount in excess of 3 per centum of the face value of such security. . . ."

This present wording of Section 3(a)(5) is the result of an amendment to the Act, which was adopted as part of the Investment Company Amendments Act of 1970. Prior to 1970, Section 3(a)(5) exempted "any security issued by a building and loan association, homestead association, or similar institution, substantially all of the business of which is confined to the making of loans to members," with the same exception as to accounts which were assessed a fee at the termination of the investment. The most notable changes to this language adopted in

1970 were (1) the addition of the more modern term "savings and loan association"; (2) the addition of language specifying that the savings and loan association or similar institution issuing the securities must be supervised and examined by State or Federal authorities having supervision over such institutions; and (3) the deletion of the requirement that all of the business of the institution be confined to the making of loans to members.

The present language conforms the exemption from '33 Act registration to that from the '34 Act. It also clearly confirms an earlier SEC position that accounts or other securities offered by foreign associations are not exempt.

Prior to 1970, savings and loan associations found it necessary to devise various methods of assuring that "substantially all of their business" was "confined to the making of loans to members," so that they could qualify for the Section 3(a)(5) exemption. In the case of a federal association, membership could be assured by the terms of the corporate charter, which generally would provide that all holders of the association's savings accounts and all borrowers therefrom are members. And the laws of many states contained similar language declaring all borrowers from state-chartered associations to be members. Some savings associations themselves conferred membership on borrowers by amending their charters or by-laws, or by contract with their borrowers. The permanent stock associations had more difficulty with this aspect of memberships, since generally only their regular stockholders had voting rights. Many such institutions issued token or fractional shares of permanent stock to each borrower at the time loans were made, thus qualifying the borrower as a member, and frequently there were provisions for redemption of the shares so issued at the time a loan was paid up. Under the present law, however, these questions no longer need concern us.

If we turn to the Securities Exchange Act of 1934, it also contains provisions requiring the registration of certain publicly-traded securities, and imposes reporting requirements on the issuers of such securities. Section 12(a) of the Act requires, in effect, the registration of securities (other than exempted securities) which are traded on a national securities exchange. Securities issued by savings and loan associations are not exempted securities for this purpose, and, therefore, if they are traded on an exchange, they must be registered. Following the registration of their securities, companies must file annual and other periodic reports to keep current the information contained in the original filing.

Pursuant to the 1964 amendments to the Securities Exchange Act, provisions of that Act apply to equity securities traded over-the-counter, if the assets of the issuers of such securities exceed $1 million, and they have a class of equity security held of record by 500 persons or more. Pursuant to Section 12(g)(2) of the Securities Exchange Act, securities issued by savings and loan associations, or similar institutions, which are supervised and examined by state or federal authorities having supervision over such institutions, are exempt from the registration and reporting requirements of the Securities Exchange Act, with one important exception: registration is required with respect to "permanent stock, guaranty stock, permanent reserve stock, or any similar certificate evidencing nonwithdrawable capital" issued by such institutions.

Generally, mutual savings and loan associations, which are recognized as such under federal or state law, need not register with the SEC under these provisions. Similarly, permanent stock associations need not register with the Commission solely by virtue of the number and size of their savings or other withdrawable accounts, which are exempted, but they are required to register their permanent equity stock if they meet the above-mentioned size tests, as are holding company affiliates or subsidiaries of savings and loan associations. Those savings and loan associations which are registered under Section 12(g) of the 1934 Act, also are subject to the periodic and ownership reporting requirements, and the provisions governing the solicitation of proxies from holders of registered shares, tender offers, repurchases by an issuer of its own shares, and insider trading, set forth in Sections 13, 14 and 16 of the Securities Exchange Act, and the Commission's rules thereunder.

To accommodate permanent stock savings and loan associations which had issued whole or fractional shares to qualify borrowers for membership, in order to meet the requirements for a pre-1970 exemption from the registration requirements of the Securities Act of 1933, the Commission adopted Securities Exchange Act Rule 12g5-1. That

Rule defines the term securities "held of record," for purposes of determining whether an issuer is subject to the registration requirements of Section 12(g) of the Act, by virtue of the fact that it has a class of equity securities "held of record" by 500 or more persons. Under the Rule, whole or fractional shares issued by a savings and loan association "for the sole purpose of qualifying a borrower for membership in the issuer, and which are to be redeemed and repurchased by the issuer when the borrower's loan is terminated" are not included as held of record by any person. This Rule has served substantially to reduce the number of savings and loan associations which otherwise would have been required to register securities under Section 12(g) of the Act.

Administration and enforcement of these provisions of the Securities Exchange Act with respect to savings and loan associations is the responsibility of the SEC. In this respect, savings and loan associations differ from commercial banks. In the case of such banks, the provisions of Sections 12, 13, 14[1/] and 16 of the Act are administered and enforced

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1/ With the exception of Subsections 14(b) and (e).

by the federal bank regulatory authorities. I understand, however, that a provision of the Depository Institutions Amendments Act of 1974, which passed the Senate on June 13, and previously was passed by the House, would transfer to the Federal Home Loan Bank Board the SEC's present authority to administer and enforce these provisions of the Securities Exchange Act with respect to institutions whose accounts are insured by the Federal Savings and Loan Insurance Corporation. If this bill ultimately is enacted into law, your contacts with the SEC may be further limited than they are today.

At present, only a few savings and loan associations are registered with the Commission under Section 12, but as conversions of mutual associations to the stock form increase, either under state law or under hoped-for federal legislation, more and more savings and loan associations are likely to find that registration is required.

While the registration and reporting requirements of the federal securities laws are limited in their application to the operations of savings and loan associations by these various exemptions, the antifraud provisions of our securities laws are not so limited. The legislative history, the statutes themselves, and administrative and court opinions interpreting the relevant statutory provisions make clear that the antifraud provisions apply to all securities issued by savings and loan associations, as well as to other securities which may be offered, sold, or purchased by such associations, including savings accounts, share accounts, permanent stock, debentures, notes, bonds, certificates of deposit, investment contracts, evidences of indebtedness, and any other instruments or arrangements which would fall within the broad definition of the term "security" set forth in Section 2(1) of the Securities Act and Section 3(a)(10) of the Securities Exchange Act.

The legislative history of the Securities Act of 1933 plainly shows that Congress recognized that share accounts in savings and loan associations were covered by the Act's definition of security. Representatives of the savings and loan industry apparently recognized that they would be subject to the Act, and sought an exemption from its registration provisions on the ground that small associations, which made continuous offerings of their shares, would find it extremely burdensome to comply with those requirements. But those industry representatives made clear that they sought only a limited exemption. Morton Bodfish, then Executive Manager of the United States Building and Loan League, for example, said to the House Committee "Now, gentlemen, we want you to leave the fraud sections there, just as they are, so that [if] any fraud developed in connection with the management of any of our institutions anywhere or under the name of building and loan, this law can be effective and operative." 2/

The Commission's view that withdrawable capital shares of savings and loan associations were subject to the Securities Exchange Act's antifraud provisions, was confirmed by the United States Supreme Court in Tcherepnin v. Knight 3/

2/ Hearings on H.R. 4314 before the House Committee on Interstate and Foreign Commerce, 73d Cong., 1st Sess. 74 (1933).

3/ 389 U.S. 332 (1967).

in 1967. And the broad implication of the Supreme Court's decision in that case is that the antifraud provisions of both the Securities Act and the Securities Exchange Act will apply to anything issued by a savings and loan association which falls within the broad definitions of "security" set forth in those Acts.

These antifraud provisions, Section 17(a) of the '33 Act, Section 10(b) of the '34 Act, and Rule 10b-5 thereunder, cover most of the day-to-day transactions of savings and loan associations, including the offer and sale of certificates of deposit, the solicitation of persons to open share accounts, or savings accounts, the acceptance of promissory notes from purchasers of real or personal property, whether or not they are secured by liens on such property; the purchase, sale, or offer to purchase or sell, of U.S. government issued or guaranteed securities, state and local government securities, and other securities in which such associations are permitted by law to invest. The antifraud provisions cover advertisements soliciting members of the public to open accounts or otherwise to invest money with a savings and loan association. In at least one case of which I am aware, the FSLIC issued an order directing an insured savings and loan association to cease and desist violating Section 10(b) of the Securities Exchange Act and the Commission's Rule 10b-5 thereunder by the use of advertisements and solicitations for savings from the public which failed to disclose, and by accepting savings from the public without disclosing, "certain adverse material facts with respect to the condition of the association . . ." 4/

Of course, the regulations promulgated by the Federal Home Loan Bank Board, and the Federal Savings and Loan Insurance Corporation, also prohibit false and misleading advertising by savings and loan associations, and in some respects the antifraud provisions of the federal securities laws are merely duplicative of these prohibitions. The real significance of the securities laws in this regard stems from the added civil liabilities and criminal penalties which may be incurred by those who violate these antifraud provisions.

So far, as you can see, we have not had a great deal to do with each other, and I suspect we have both rather

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4/ Federal Savings and Loan Insurance Corporation v. Apollo Savings, 285 F. Supp. 750 (N.D. Ill., 1968).

liked it that way. How long it will continue, I don't know. Some of the Hunt Commission recommendations would enable associations to get deeply involved with mutual funds, where we would meet you under the Investment Company Act of 1940, as well as the '33 and '34 Acts. Pending legislation would increase your use of the products of our disclosure system by permitting you to invest in debt securities.

Beyond this, I suggest we all agree that our financial institutions seem to be facing a turbulent future. To the difficulties raised by the cost of money and its scarcity, which are quite formidable enough, we must add problems raised by holding companies and diversification. Among other things that may well change over the next few years, are the jurisdictions of the several acts and agencies to conform to the new reality, whatever it should turn out to be.