THE SECURITIES ACTS AMENDMENTS AND THEIR IMPACT ON MANAGEMENT

Address by

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Senator Williams has provided a comprehensive picture of the Special Study recommendations which were the genesis of the Securities Acts Amendments of 1964, the questions which arose during the Congressional hearings, and the means by which the desired results were ultimately achieved. The credit for the enactment of the Amendments is due, in large measure, to the leadership of Committee and Subcommittee Chairmen on both sides of the Congress, notably Senator A. Willis Robertson and Senator Williams, and Congressmen Oren Harris and Harley O. Staggers, their counterparts in the House.

During the five years preceding my appointment in March 1964 to the Securities and Exchange Commission, I was Administrator of the Oklahoma Securities Act. The Oklahoma Act, as are many State securities laws, is to a degree paternalistic. By this, I refer to the prevalent statutory authority by which the administrative officer is allowed to deny a registration in the public interest if, in his judgment, it does not meet statutory standards such as "fair, just and equitable." The primary thrust of the Oklahoma Act is, however, toward meaningful disclosure of material facts. The Securities Act of 1933, arising as it did from Congressional hearings which revealed substantial fraudulent activity throughout the national securities markets, and having been enacted at the depth of the Great Depression, might have adopted the paternalistic approach of many existing State statutes. The Congress, however, determined that access to the capital markets of this country should be available to all, subject, however, to the requirement that investors and prospective investors be given "the truth, the whole truth, and nothing but the truth." The wisdom of this determination has been proven almost daily in the intervening 32 years. Once people are provided with all the facts, they should be allowed to exercise *their own* judgment. The 1933 Act allows them to do just this, and it imposes both civil and criminal liability on those who would practice deception on public investors.

The Securities Exchange Act of 1934 complements the 1933 Act in that it provides for self-regulation by national securities exchanges under appropriate guidelines and procedures designed to prevent a recurrence of the excesses of the 1920s. It further provides for registration of brokers and dealers, the principal conduits through which information reaches the investing public. Although the Exchange Act is generally looked upon as being regulatory in nature, it is quite clear that the Congress employed the basic disclosure philosophy here, as well as in the 1933 Act. This can be seen in the reporting requirements of Sections 12 and 13 and the proxy requirements of Section 14, all of which are applicable to issuers.

Section 15, providing for registration and regulation of brokers and dealers, and Section 15A, added in 1938, authorizing the formation of self-regulatory national securities associations, are primarily regulatory in nature. Their effect, however, has been to further the scheme of disclosure by making certain that those persons with whom the public investor is in closest contact will provide only accurate and complete information regarding securities. Even the insider provisions of Section 16 employ the disclosure concept. Persons who are in a position to benefit from inside information at the expense of the public investor are required by Section 16(a) to report their holdings and any changes in them. Section 16(b) makes an insider liable for any profits made from "short-swing" purchases and sales. The liability provided by this provision inures to the benefit of the issuer involved and, therefore, to its security holders. This is perhaps a roundabout application of the disclosure concept, but it is, nonetheless, a very real one. I will discuss Section 16 in more detail a bit later.

The distinguished speakers and panel members coming before you during the next two days will examine the impact of the 1964 Amendments upon specific areas of your businesses in great detail. With this in mind, I would like to spend some time discussing particular portions of the Exchange Act to which over-the-counter issuers will be subject under the Amendments. I will also try to provide a general picture of the SEC's implementation program under the Amendments.

The new Section 12(g) is the registration requirement. It comes into play only IF: (1) the issuer is engaged in interstate commerce or in a business affecting it, or its securities are traded by use of the mails or means or instrumentalities of interstate commerce; (2) the issuer has total assets of more than one million dollars; and (3) the issuer has a class of non-exempt equity securities held of record by 750 or more persons. All three prerequisites must be present before registration is required. In the great majority of cases, there will be no question. An issuer either will or will not meet the three tests. It is anticipated, however, that there will be borderline cases. This is pointed up by the fact that our preliminary study indicates that approximately 900 issuers will be brought under Section 12(g) after July 1966, when the shareholder requirement will automatically be reduced to 500 from the present 750. In order to assist issuers and their advisers in determining the applicability of these requirements, we have adopted Rules 12g5-1 and 12g5-2, which define the terms "held of record" and "total assets," respectively. I shall reserve to Mr. Shreve a more detailed analysis of these rules later this morning.

Although the Act was signed into law on August 20, the effective date of the registration requirement is July 1, and registration statements were to be filed within 120 days after the end of the issuer's first fiscal year ending thereafter. Shortly after the enactment of the Amendments, we adopted Rule 12g-1, which extended the time for filing registration statements to April 30, 1965. The extension did not exempt any issuer, but allowed more time for preparation. A majority of the companies covered by Section 12(g) are thought to be on a calendar year basis, and would be required to file no later than April 30 in any event. This extension, therefore, aided those issuers whose fiscal years ended during the last half of 1964.

Prior to the enactment of the 1964 Amendments, the only successful, albeit limited, effort to extend the reporting requirements of the Exchange Act into the over-the-counter markets was Section 15(d), which has been in effect since 1936. This provision brought companies filing registration statements pursuant to the Securities Act of 1933 under the reporting requirements of Section 13

of the Exchange Act, which requires periodic financial reports and reports of significant corporate events. By contrast, Section 12(g) imposes the registration, reporting, proxy and insider requirements of the Exchange Act or, in other words, the full range of requirements applicable to listed companies. Section 12(g) also may be applicable whether or not a 1933 Act registration statement has ever been filed by the issuer. The statutory obligations imposed by these sections may be suspended upon a showing that the class of securities registered has come to be held of record by fewer than 300 persons. Section 15(d) companies which are not exempted are required to register under Section 12(g), but only if they meet the three conditions which I have heretofore stated.

The extension of filing time in Rule 12g-1 was specifically not applicable to Section 15(d) companies. They had previously gone through the registration process, and were therefore thought to be able to register without difficulty. Our Form 8-A provides a simplified process for these registrants.

The registration statements do not become effective until 60 days after filing, or such shorter time as the Commission may direct. It should be noted here that the legislative history of this provision makes it clear that acceleration of the effective date should occur only at the request of the applicant. The reason for this unwritten limitation is seen in the fact that the reporting, proxy and insider provisions are applicable when the securities become registered.

In order to clarify the terms employed here, and at certain other points in the Exchange Act, we have adopted Rule 12b-6 which provides, in effect, that securities are "registered" when the application or registration statement filed pursuant to Section 12 becomes effective. This interpretive rule precludes any reading of the word "registered" as synonymous with the original filing of the application or registration statement.

The trickle of registration statements received to date will, we are certain, reach flood proportions by April 30. We are as ready as we will ever be for this deluge. Detailed examination of each of these registration statements, and correction of deficiencies by management within the 60 days prior to effectiveness will be, quite frankly, a physical impossibility. As we have advised the Congress, our staff will be working night and day, but we can give no assurance that even this will be enough. Section 18 of the Exchange Act provides civil liability against any person making a false or misleading statement in any document filed with the

Commission pursuant to that Act. Damages may be recovered by any person who did not know of the false or misleading nature of the statement and who purchased or sold a security at a price which was affected by the statement. This provision is automatically applicable to registrants under Section 12(g) upon effectiveness of the registration--60 days after filing. With this in mind, it is clearly incumbent upon management to take special care in the preparation of these registration statements. Our examination process is merely an assistance to management, which bears the ultimate responsibility for all material filed, whether or not examined by our staff. I cannot, therefore, emphasize too strongly the vital importance of completeness and accuracy from the very beginning.

Rule 12g-1 also suspends application of the proxy rules until two months after the last date on which a registration statement under Section 12(g) is due, or December 31, 1965, whichever is earlier. This portion of the rule applies to all issuers subject to registration under Section 12(g), _including_ the 15(d) companies.

We assume that the proxy rules will not be applicable in many, if not most, cases until the spring of 1966. A company operating on a calendar year basis will normally hold its annual meeting of shareholders in the spring of the following year, soon after the financial statements are ready for dissemination to stockholders. The two-month delay in application of the proxy rules will extend the crucial date to June 30, 1965 in most cases, and this is well after what our staff painfully refers to as the "proxy season." The same component of our staff (with some, but not enough, additions) will be responsible this April for the Section 12(g) filings as well as the normal flow of proxy statements from listed companies. Unlike most of us, therefore, the mere mention of spring strikes apprehension in their hearts.

Andy Barr, our Chief Accountant, who is here this morning, will act as chairman of the excellent panel this afternoon. I defer, therefore, to him and his panel members a detailed discussion of the reporting and financial statement requirements of Sections 12 and 13.

Section 14 of the Exchange Act contains the proxy requirements. It is applicable to listed companies and Section 12(g) companies alike. Paragraph (a) of the section is quite simple. Its provisions make it unlawful for any person to solicit, or permit the use of his name to solicit, a proxy, consent or

authorization in respect to any security registered under Section 12 of the Act in contravention of Commission rules prescribed as necessary or appropriate in the public interest or for the protection of investors. The rules which have been issued under this provision make up in comprehensiveness what they lack in simplicity. They cover the full range of information which must be provided to shareholders in any solicitation, including the form and content of the proxy itself. They cover almost every eventuality, without being inflexible. There are complete guidelines as to what actions are required of both sides in the event of a proxy contest. While the rules are somewhat, albeit unavoidably, complex, they do accomplish their primary purpose; namely, that of assuring that shareholders are provided the most complete and accurate current information in order that they may exercise an informed judgment as to how their shares should be voted. Further, shareholders must be allowed a choice in proper cases, so that they are not required to choose between voting "aye" and not voting at all.

An amendment to paragraph (b) of Section 14 allows the Commission to promulgate rules governing the conduct of registered broker-dealers concerning the giving, or refraining from giving, proxies with respect to any security registered under Section 12, and carried in "street name" for the account of a customer. Section 14(b) will now apply to all registered broker-dealers rather than merely to those who are members of a national securities exchange. Previously, we had the power to <u>prohibit</u> the giving of proxies in contravention of our rules, but lacked power to <u>require</u> that proxy materials be transmitted to the beneficial owner. Nor could we require that a proxy be executed by the broker-dealer in accordance with the owner's wishes.

The New York Stock Exchange and certain other exchanges have rules which regulate the giving of proxies by members. These rules require the forwarding of proxy solicitation material received by the record owner if the solicitor pays the expenses. The record owner may either request voting instructions or enclose a proxy which the beneficial owner may or may not give, as he sees fit. While these rules afford considerable protection for the "street name" shareholder who deals with a member of these exchanges, they cannot be of benefit to the owner of a "street name" security whose broker is not an exchange member. It is for this reason that paragraph (b) was expanded by the 1964 Amendments. We have not as yet published rule proposals in this area, but it may be assumed

that such rules, when published, will be at least comparable to the exchange rules which I have outlined and, of course, be designed to provide equivalent protections for "street name" holders of both listed and 12(g) registered securities.

Paragraph (c) of Section 14 is new, having been added by the 1964 Amendments. At present, the New York and American Stock Exchanges require that listed companies solicit proxies for all meetings of shareholders. Unlisted companies and those listed on some other exchanges are not subject to this requirement. The result, therefore, has been that any company which could count on having a quorum present at meetings in the persons of management and those friendly to management could avoid furnishing the valuable information required by the proxy rules by simply not soliciting proxies. When proxies are not solicited by or on behalf of management, paragraph (c) requires that all holders of both listed securities and over-the-counter securities registered under Section 12 be provided with "such security information substantially equivalent to the information which would be required to be transmitted if a solicitation were made . . ." We have published for comment proposed extensive rules under this provision. These rules, except for solicitation and contest provisions, are virtually identical with those issued under paragraph (a). Therefore, upon adoption of these rules, all shareholders, whether or not their proxy is required by management, will be provided basically the same information. In the event of a contest, paragraph (a) will, of course, come into play since this would undoubtedly result in a "solicitation."

We have also published extensive amendments to the present proxy rules, many of which are merely technical in nature. Some, however, are substantive in scope, and have caused some concern among the listed companies which have already begun preparation of their proxy information for the current "season." Our staff has advised us that they will recommend that these amendments not be made effective as to proxies solicited during the current "season," so that there will be no question as to what rules apply, and so that solicitation materials submitted in the interim will need to comply with only the existing set of rules.

While the extension of the proxy requirements to unlisted issuers will impose added responsibilities upon management, it will also provide the protection of the same requirements and the same high standards of disclosure in the event of a contest.

All proxy solicitation materials, and all 14(c) materials as well, must be filed with the Commission at least 10 days prior to the date on which copies of the information are first sent or given to security holders. This allows our staff to examine the proposed materials for deficiencies and call deficiencies to the attention of management for correction before use. This process aids management in complying with these rules.

An understanding of, and compliance with, the proxy rules is an absolute necessity for management of companies to be registered under Section 12. This is vividly apparent when one considers recent judicial decisions which in some instances imply, and in others enforce, private rights of action for non-compliance with the proxy rules. These decisions indicate that non-compliance with these rules may invalidate corporate action otherwise valid under the applicable State law, and may give rise to independent claims for damages. The landmark case in this area is J. I. Case vs. Borak, decided by the United States Supreme Court on June 8, 1964. Since our General Counsel, Phil Loomis, very ably briefed and argued that case for the Commission before the Supreme Court in the capacity of friend of the court, I will ask that he provide you with his thoughts concerning the ultimate thrust and implications of that opinion, and others of like import.

Another area which should be fully understood by management is Section 16, which I briefly discussed earlier. The provisions of Section 16 are generally referred to as the "insider trading" provisions. An "insider" is any officer or director of the issuer of any equity security registered under Section 12, or any person holding, directly or indirectly, the beneficial ownership of more than 10% of that class of security. Section 16(a) requires that a report be filed by each "insider" at the time of registration of such a security. This report, for which our Form 3 has been provided, must reveal the amount of all equity securities of the issuer of which he is the beneficial owner. He must also report changes in such ownership within 10 days following the close of each month in which they occur. The reports of change are to be made on our Form 4.

Section 16(b) provides that any profits made by an insider, in a purchase and sale (or a sale and purchase) of an equity security of the issuer within six months, inure to the issuer, and can be recovered by the issuer or on its behalf by any shareholder. It has

recently been said by a knowledgeable attorney that in view of the applicability of this provision to persons and firms who may be completely unaware of its consequences, the best advice he could give a client would be as follows: No insider should buy or sell a share, exercise an option or a conversion privilege, or so much as consider any such action, or any other action remotely related to securities of the issuer, without consulting counsel before the fact. With the short-swing profits provision now of almost universal application, it would seem that any attorney would be well advised to give such advice to his clients, and all management personnel and other "insiders" would clearly be well advised to give it heed.

Both management and counsel should study the rules which have been adopted by the Commission providing specific exemptions from the operation of Section 16(b). These cover certain specific types of transactions, and it may well be that particular factual situations thought to pose problems in this area have been resolved by the Commission pursuant to its exemptive authority.

Section 16(c) makes it unlawful for any insider to make any short sale or "sale against the box" as to any equity security of the issuer.

Section 16(d) was added by the 1964 Amendments, and constitutes the only substantive change in the Section 16 structure. This change pertains to market-making in over-the-counter issues. Market-making commonly flows from an underwriter relationship carrying an obligation to sponsor securities in the "after-market." It is not at all uncommon for a market-maker to be represented on the board of directors of the issuer in whose securities he is making a market. Of course, the application of Section 16(b) to the over-the-counter markets would severely inhibit such functions in these circumstances, since any profits made by the director in his market-making capacity would be recoverable by or for the issuer. The Special Study recommended no general exemption for this situation. Following the Special Study, further consideration was given to this subject. The Commission determined to recommend such an exemption, subject to its power to define all key terms and to prescribe terms and conditions limiting the exemption. It was, and is, felt that these rule-making powers and the Section 16(a) reports, when employed in conjunction with the disciplinary powers of the Commission, would provide a surveillance tool sufficient to prevent abuses in this area. The Commission therefore submitted, and the 1964 Amendments provide, an exemption for "market-makers" from the provisions of Section 16(b).

This exemption is limited to securities not then or theretofore held in an investment account, and to securities held in the ordinary course of business and incident to the establishment or maintenance of a primary or secondary market for the security. Rules under this section will be published in the near future to make the scope of the exemption more definite and to insure that this limited exemption may not be used for conscious circumvention of the provisions of Section 16(b). Such circumvention would defeat the salutary purposes for which the provision was enacted.

Most certainly it shall not be my intention of arguing here the merits and demerits of the Section 16 philosophy, as I have conceived no possible discussion of this subject which would not elicit strong views on both sides of the question. Suffice it to say that Section 16 is a reality of life in the Exchange Act and that it will probably remain there. Understanding by management and counsel of its requirements and liability provisions is all we seek.

The 1964 Amendments contain numerous provisions which affect broker-dealers and their employees. Some have been thoroughly discussed by Senator Williams, and some of them will be the subject of detailed analysis later in your program. Certain of these provisions are designed to allow both the Commission and the National Association of Securities Dealers to cull out the individual "bad apples" in the industry without unduly injuring innocent co-workers or employers, and to impose sanctions on both individuals and firms which more nearly fit the offense charged. Previously, we were faced with sanction provisions which all too often provided us with the impractical alternative of either slapping an offender on the wrist or lopping off his head--there was nothing in the middle.

The Amendments also substantially strengthened the power of both the Commission and the NASD to deny registration to persons who are not qualified. The standards for such denial, and for removal of the privilege once granted, have been broadened considerably. It has been said that the Amendments, once and for all, scuttle the philosophy that there should be "free entry" into the over-the-counter markets. If such philosophy was extant, it undoubtedly has been scuttled! The Special Study made it clear that the distinction between the exchange markets and the over-the-counter markets in this area, as in the disclosure area, simply had no justification. In fact, it demonstrated that the public interest requires that standards for entry into these markets should be at least as exacting as those applied to the exchange markets. After all, the marketplace itself,

being the entire nation, is not as susceptible to constant oversight by regulatory authority, whether it be the Commission or a self-regulatory body.

The Congress unquestionably wants the standards of entry into the securities industry raised, and its desires are expressed in language which is far more mandatory than it is precatory.

These provisions concerning broker-dealers do not directly affect management of issuers, but they, and the rules adopted under them, should be of great benefit to management through the results which are sought, and which I believe will be obtained.

The 1964 Amendments were enacted for one broad purpose; namely, to strengthen the securities markets of this country. The registration requirement, and the reporting, proxy and insider provisions which come with it, insure a degree of quality and uniformity in corporate information which has never been present in the over-the-counter markets. This alone should greatly increase public confidence in these markets. The broker-dealer provisions will insure that only those qualified to deal with the public in the securities business are allowed to do so. They will allow the Commission and the NASD to punish more appropriately those who would deal unfairly with their customers, or otherwise violate the provisions of the securities laws. Through these seemingly dissimilar sets of provisions, the over-the-counter markets will undoubtedly achieve a stature in the eyes of the public in which they have never before been held. Such a result is fervently to be desired and sought by everyone concerned.

We at the SEC do not consider these Amendments a panacea for all problems which face the securities industry. As in any other vital industry, there will always be problems. No statutes or rules can be written which would wholly preclude abuses. Even if that could be done, such requirements would necessarily be so restrictive that the industry would smother by the weight of its own safeguards.

Our function, and that of management and its spokesmen such as yourselves, is to operate within the framework of the Federal securities laws. This framework, as I have noted, has as

its keystone the principle of disclosure. It also has, as a major portion of its basis, the philosophy that self-regulation and cooperation are not only workable in the national scheme of things, but are superior to any other alternatives which may present themselves. The NASD and the national securities exchanges have demonstrated over the years that this philosophy is correct.

We at the Commission are convinced that these 1964 Amendments will be of significant benefit to management, the securities industry, the public investor and the capital markets of this country. This will become apparent to all concerned when the provisions have become fully operative and have been given a chance to do the work for which they are designed.

It is clear from the Committee reports which accompany the Amendments that the Congress is likewise convinced that these results will obtain. The same is true of the White House. I was privileged to be present on August 20, 1964, when President Johnson signed the Amendments into law. At that time, he said:

> "The law signed today should further strengthen the securities markets and public confidence in them. Industry and government have worked together in the writing of these laws. Industry and government will work together in making these measures succeed."

The theme of the President's statement has been the basic tenet of my administrative philosophy for the past six years. I can, therefore, heartily subscribe to it.

In the coming two days, your speakers and panelists will describe the effect of these Amendments upon your individual situations, and the benefits to all concerned will undoubtedly become apparent. Like all other laws, the Securities Laws cannot function in a vacuum. In order for salutary results to be achieved, these laws require, as the President has indicated, understanding and cooperation from management of the organizations which they affect. This conference was designed to those ends. Thank you for your efforts toward making cooperative regulation an accomplished fact.

in this area