THE SECURITIES ACTS AMENDMENTS AND THE INVESTMENT BANKING COMMUNITY

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Before
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San Antonio, Texas
April 8, 1965

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In speaking to you today on the Securities Acts Amendments of 1964, it might be well to state at the outset that I will try to place particular emphasis upon the effect of these Amendments in relation to the investment banking community.

The Amendments are of importance to all persons involved in the securities markets of this country, whether they be issuers, broker-dealers, or investors. I would like to discuss briefly some of the changes made by these Amendments, their expected benefits and, in some cases, the abuses or inequities which they were designed to attack.

The requirement that certain over-the-counter issuers register under the Securities Exchange Act of 1934 has probably received the most attention in the popular press and in financial publications. While this requirement will affect investment bankers only tangentially, the effect will be a beneficial one, as I will hereinafter point out.

Section 12(g) is the new registration requirement. It requires an issuer to register if it has total assets of more than one million dollars _and_ a class of non-exempt equity securities held of record by 750 or more persons. After July 1966, the shareholder requirement will automatically be reduced to 500, and our preliminary study indicates that approximately 900 additional companies will then be subject to these requirements. Since this indicates that there will be borderline cases, we have adopted Rules 12g5-1 and 12g5-2, defining "held of record" and "total assets," in order to assist issuers and their advisers. The date for filing registration statements has been extended to April 30 of this year in order to provide additional time for preparation by those companies whose fiscal years ended during the last half of 1964.

Registration under Section 12(g) imposes the reporting, proxy and insider requirements of the Exchange Act, the full range of requirements heretofore applicable only to listed companies.

The 12(g) registration statements do not become effective until 60 days after filing, unless the issuer requests acceleration. 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, therefore, any reading of the term "registered" as synonymous with the original filing of the document.

We anticipate that our proxy rules will not be applicable to most 12(g) companies until June 30, 1965, which 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) is now laboring over the deluge of 12(g) filings as well as the normal flow of proxy statements from listed companies. Unlike most of us, therefore, the coming of spring was greeted in their offices with something less than unqualified joy. Next spring they may look forward to yet another deluge--the first proxy statements from 12(g) companies.

The general proxy solicitation provision, Section 14(a), was not affected by the 1964 Amendments. I would like, therefore, to discuss the changes made in other paragraphs by the 1964 Amendments.

Section 14(b) was amended to allow the Commission to promulgate rules governing the conduct of registered broker-dealers as to the giving, or refraining from giving, proxies with respect to any security registered under Section 12. This, of course, includes both listed securities and those registered under Section 12(g). This provision now applies to all registered broker-dealers, and not merely to members of a national securities exchange, as was the case previously. Before this amendment was enacted, we could <u>prohibit</u> the giving of proxies in contravention of our rules, but could not <u>require</u> that proxy materials be transmitted to the beneficial owner. Neither 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 afford considerable protection for the "street name" shareholder who deals with a member firm. Section 14(b) was expanded so that <u>all</u> owners of registered securities would be afforded equivalent protections in this area. We have not as yet published rule proposals under this provision, but it may be assumed that such rules, when published, will be at least comparable to the exchange rules which I have mentioned.

Section 14(c) was added by the 1964 Amendments. When proxies are not solicited by or on behalf of management, Section 14(c) requires that all holders of securities registered under Section 12 be provided with "security information substantially equivalent to the information which would be required to be transmitted if a solicitation were made . . ." Although the New York and American Stock Exchanges require generally that listed companies solicit proxies for all meetings of shareholders, unlisted companies and those listed on other exchanges are not subject to this requirement. It is possible, therefore, that the desirable effects of the proxy rules could be circumvented by simply not soliciting proxies from all shareholders. Section 14(c) was designed to ensure that shareholders who are not solicited are nevertheless provided with information concerning actions proposed to be taken at the meeting. We have published for comment proposed extensive rules under this provision which, when adopted, should achieve these ends.

Another area of vital importance, now applicable to Section 12(g) companies, is that of the "insider trading" provisions of Section 16. Any officer or director of an issuer whose equity securities are registered under Section 12, and any person holding directly or indirectly the beneficial ownership of more than 10% of that class of security, is an "insider" for purposes of these provisions. Section 16(a) requires that each insider file a report at the time of registration of the security, or when he becomes an insider, revealing the amount of all equity securities of the issuer of which he is the beneficial owner. He must also report all changes in such ownership within 10 days following the end of the month in which they occur.

Section 16(b) allows the issuer to recover, through direct or derivative action, any profits made by an insider, in a purchase and sale (or a sale and purchase) of an equity security within any six-month period. The terms "purchase" and "sale" have been liberally construed by the courts in order to give full effect to the purposes for which the provision was enacted. An experienced practitioner has recently said 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 conversion privilege, or take any action related to securities of the issuer, without consulting counsel before the fact. I would say that all "insiders" would be well advised to follow this advice.

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.

The only substantive change in the Section 16 structure pertains to market-making in over-the-counter securities. It is not uncommon for a market-maker to be represented on the Board of Directors of the issuer in whose securities he is making a market. Further, the market-maker may, at some time, become the owner of more than 10% of the class of securities in which he is interested. Of course, the application of Section 16(b) would severely inhibit the market-making function in these circumstances, since any profits made by the insider in his market-making capacity would be recoverable by or for the issuer. The Commission recommended, and the new Section 16(d) provides, an exemption for such situations, subject to its power to define all key terms, and to prescribe conditions limiting the exemption. These rule-making powers and the Section 16(a) ownership reports, when employed in conjunction with the disciplinary powers of the Commission, should provide a surveillance tool sufficient to prevent abuses in this area. The 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. The exemption does not affect the requirements of Section 16(a).

Rules under this provision will be published in the near future to make the scope of the exemption more definite and to ensure that this limited exemption may not be employed for conscious circumvention of the provisions of Section 16(b), thus defeating the salutary purposes for which the provision was enacted.

As I observed at the beginning of my remarks, the effect upon the investment banking community of the registration requirement and its attendant provisions is tangential, but will be highly beneficial. The basic philosophy behind this requirement was that which has been the keystone of the securities laws since 1933; namely, disclosure. The over-the-counter markets have clearly experienced phenomenal growth, especially during the post-war years. Just as clearly, the distinction between these markets and the exchange markets in the quality and amount of disclosure provided to shareholders was simply not justified. The Maloney Act, in 1938,

went a long way toward controlling abuses by brokers and dealers and their employees in authorizing the creation of self-regulatory associations of securities firms--this, of course, was the birth of the NASD. There was, however, virtually no control over the dissemination of information to shareholders by issuers of over-the-counter securities until the 1964 Amendments.

We at the Commission feel that registration under Section 12(g), and its attendant responsibilities and obligations, will ensure a degree of quality and uniformity in corporate information which has never before been present in the over-the-counter markets. This alone should greatly increase public confidence in these markets, and this confidence will inevitably be translated into a general strengthening of all the securities markets of the country. Such a result is fervently to be desired by the brokerage community, which, in the final analysis, should reap the primary benefits from this accomplishment.

Operating in tandem, so to speak, with the registration provision are the various provisions directed toward strengthening regulation of brokers, dealers and their employees by the Commission and by the Commission's regulatory "right hand," as it were, the NASD.

Prior to the 1964 Amendments, the Commission was faced with sanction provisions which all too often provided the impractical alternative of either slapping an offender on the wrist or lopping off his head--there was nothing in the middle. We now have the power to proceed directly against individual employees of broker-dealers where such is warranted. We also may impose sanctions on both individuals and firms which more nearly fit the offense charged. For instance, previously we could suspend a firm from membership in the NASD, or expel it from that Association. We could revoke the registration of a broker-dealer, but we could not suspend it. Now, we may suspend registration for a period of not more than 12 months, or censure the firm, in addition to the previous remedies. As to individuals against whom proceedings are instituted, we may censure, suspend the individual from association with a broker-dealer for not more than 12 months, or indefinitely bar him from such association. These sanctions may be imposed whether or not the individual is then associated with a broker-dealer.

Both the Commission and the NASD are now provided with more specific, and more meaningful, powers to deny registration or membership. These powers extend as well to removal of either privilege, once granted. Qualification standards were significantly raised by the Congress in several areas. As in the area of shareholder information, the distinction which existed here between the exchange markets and the over-the-counter markets simply had no justification. In a "market place" which comprises the entire nation, high standards must be established and maintained. Maintenance of these standards is the responsibility of members of the brokerage community, with the Commission and self-regulatory bodies acting as overseers and, where necessary, enforcers.

The new sanction provisions and the elevated standards imposed by the 1964 Amendments bring the importance of supervision into sharp focus. Both the Commission and the NASD have enunciated the responsibility of broker-dealers and their supervisory personnel in this vital area on many occasions. Now, however, inadequate supervision of employees constitutes a specific statutory ground for disciplinary proceedings. In a specific statutory exception, the Congress has, to say the very least, encouraged broker-dealers to establish and enforce comprehensive supervision procedures. If such procedures can reasonably be expected to detect and prevent violations, and if they are properly implemented by both the firm and its supervisory personnel, no findings of failure to supervise may be made. Of course, many firms now have such procedures and enforce them wisely and well. Those who do not, however, would do well to follow these leaders. As Mr. Robert Haack, President of the NASD, succinctly stated it recently: "Supervision is now the name of the game."

These new provisions, which are all interrelated, will allow both the Commission and the NASD great flexibility in exercising their administrative responsibilities under the securities laws.

The individual "drifter," "floater," or "high-binder" may be, where necessary, removed from the securities business without injury either to the firm which employed him or to his supervisor and co-workers. On the other side of the same coin, however, is the fact, as I have stated, that both the firm and the supervisor may be disciplined for failure to supervise an employee if procedures were either inadequate or unenforced.

The 1964 Amendments give the NASD specific authority to make rules relating to the financial responsibility of members. Along these lines as well is our proposal to amend the net capital rule. Under this proposal, a minimum net capital would be required for the first time. This was a very strong recommendation of the Special Study. It hypothesized that where management has little or nothing "at risk" in the way of committed capital, it could be, and often was, less mindful of its responsibilities under the securities laws, and of its obligations to customers and other broker-dealers. I am sure you are all aware of the provisions of this proposal. I will add only that, should the amendment be adopted, its effect and its impact on the brokerage community would be given continuous and intensive study.

Another area of specific, and strong, recommendations of the Special Study is that of published quotations relating to over-the-counter securities. One of these recommendations has been, in part, implemented by the NASD in recent months by requiring the publication of the "inside" or inter-dealer bid and ask quotations on a portion of those securities for which quotations regularly appear in the public press. The 1964 Amendments specifically require the NASD to have rules which govern the form and content of quotations disseminated by any member. These must produce fair and informative quotations both at the wholesale and retail level, and prevent fictitious or misleading quotations. The adoption of the new procedure is clearly a step in the right direction. Whether or not it is the complete answer is now the subject of intensive study by both the Commission and the NASD. The result of these studies will aid in the determination of what, if any, further action is required by either body in order to meet the Congressional mandate.

Of particular importance to broker-dealers who are not members of the NASD are the provisions of Sections 15(b)(8), (9) and (10), which were added by the Amendments. We had proposed originally that membership in a registered securities association (the NASD is the only such organization at present) be made compulsory. The Congress, however, took another approach and, in doing so, placed its imprimatur on the basic principle underlying our proposal; namely, that comparable regulation should be provided all brokers and dealers registered with the Commission. The approach taken in the Amendments provides in effect that non-NASD members, in order to engage in business, must meet such standards of qualification, including training and experience, as the

Commission may by rule prescribe. These standards may be delineated in rules which classify firms, their principals, their supervisory personnel, and other employees, and which may also provide for an examination to ensure that the standards are met. Employees may be exempted from experience requirements if the other standards are satisfactorily met, but principals and supervisory personnel may not be so exempted. The provisions are quite similar to those which govern the NASD in this area, and while it may be expected that the standards established will be comparable, they will not be identical to those of the NASD. If Congress had intended a total mirroring of the NASD procedures, it would have so indicated. Even aside from this, it is quite possible that the firms coming under these provisions may have different problems from those who seek NASD membership, thereby necessitating somewhat differing treatment.

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 the securities industry, 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.

When the 1964 Amendments have become fully operative and have been given a chance to do the work for which they are designed, their benefits will be apparent to all. It is clear from the Committee reports which accompany the Amendments that the Congress is likewise convinced that beneficial 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 and do, therefore, heartily subscribe to it.

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 those persons intended to be benefited. The Securities Acts Amendments of 1964 were designed to benefit all persons interested in the securities markets of this country, through the cooperative efforts of the Commission, the self-regulatory bodies and the members of the brokerage community. Thank you for your efforts toward making cooperative regulation in this area an accomplished fact.