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THE SEARCH FOR CLARITY AND CERTAINTIES IN SECURITIES TRANSACTIONS WITH MORE AND MORE REALISTIC INFORMATION FOR INVESTORS

An Address by

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I am happy to be here today at this conference on our Rule 144. But Rule 144 is only one part, although a very important one, of our evolving disclosure system at the Commission and what I really want to say to you today concerns that disclosure system and where it is going.

I came to the Commission a year ago with four convictions about our system of disclosure for investors. The first was that the American capital market is the best in the world in large measure because the American investor is the best informed and best protected in the world. The second was that investor protection and confidence could be improved by converting much of the boiler plate that had developed into more specific disclosure about actual and emerging economic reality about the enterprise and the market in which it operates. The third was that our equity markets, particularly in the small business and venture capital areas, could be made more efficient and dynamic if we could develop greater certainty and clarity in the rules governing securities transactions. Finally, I felt that there was a greater investor stake in making accounting more comparable, more definite and certain, and more revealing of the facts of life than any other area of investor protection. After a year in office, I think I see a pattern of the Commission's disclosure policies taking

shape, which will be more effective and less burdensome and contribute significantly to greater investor protection and confidence.

The current system can be looked at as having three phases; the framework of rules which control the circumstances under which security transactions can occur; the character and method of disclosing relevant information about the issuer of a security; and rules designed to achieve adequate, reliable and comparable standards of financial reporting.

Rule 144, the culmination of almost three year's work by our Division of Corporation Finance, is finally effective. I won't go into detail about it -- you've heard from people far more expert than I. But I do want to cite Rule 144 as a step forward into objectivity, and away from SEC "theology," that is representative of our new disclosure system. For one thing, it is largely pinned on the continuous reporting system of the 1934 Act, as suggested by the seminal Harvard Law Review article by Milton Cohen and the Wheat Report. For another, it removes the often capricious application of the highly subjective "change of circumstances" fiction.

Lastly, although there is an exception for O-T-C companies providing the information called for under

Rule 15c2-11, Rulle 144 encourages issuers to voluntarily come in and file with us. In either case, we will have more companies making information available to the public.

Rule 144 will be only the first of a series of rules governing heretofore troublesome aspects of the securities offering and resale process.

A parallel development to the making of standards for restricted stock more objective is our current project to come forth with more understandable rules regarding the question of what constitutes a public offering. Our Division of Corporation Finance, and more specifically its director, Alan Levenson, have undertaken to examine whether the Commission, with the help of Bar and industry groups, can formulate a satisfactory objective rule in the private placement area. The work has been going forward and I am hopeful that a favorable report can be made on it sometime during the summer.

A final "theological" area -- and this one is probably the most holy for securities lawyers of all -- is the "no-sale" concept of present Rule 133. The Commission has before it now proposals to drastically revise the disclosure and resale rules that come into effect upon mergers and acquisitions of companies. We hope to promulgate for comment next week revisions in this area which will, in effect, repeal Rule 133 and replace

it with a new rule that is not pinned on an artificial concept like the "no-sale" doctrine. Although more registration will be required in the merger area system when the new rule goes into effect, there are also provisions making registration simpler by use of "wrap-around" prospectuses, and allowing limited amounts to be sold without registration in transactions resembling Rule 144 situations. The Commission met with much resistence a few years ago when it proposed to abolish Rule 133. We feel that the bar, the investment banking, and the venture capital communities are better prepared now to accept its inevitable demise, particularly in conjunction with proposals designed to make compliance simpler and the rules on resales of stock clearer. We will not have a long comment period; there is not much left to say. We hope to have an effective rule by July to remove any anomalies that may result from the parallel existence of new Rule 144 and old Rule 133.

The culmination of these three projects -- a framework of rules making the requirements of registration in certain areas more objective and simpler to understand -- is designed to convert what is generally considered to be a troublesome annoyance in a business context to a true information-producing mechanism. But we are also moving to try to make disclosure more understandable, and more relevant to the protection of investors.

Disclosure has been an arcane business. The real problem of securities work is that the caution that has gone into the disclosure process has produced items so carefully hedged that few investors can make use of them. Reams of boiler plate incantations were spawned by years of lawyers looking out for their client companies. These doom-filled documents have become largely ignored in the fourth decade of their existence.

We have continued over the years to work on the content of registration statements. Perhaps the most interesting recent content reform is our proposed set of rules regarding the disclosure of material litigation, particularly in the environmental area. As most of you know, the environment normally features heavy in our problems regarding proxy statement shareholder proposals. We had also received some suggestions from public groups that we were not living up to our responsibilities under the National Environmental Policy Act. I said last year, and I reiterated recently before Congressman Dingell's subcommittee, that our primary responsibility is to protect investors by requiring disclosure of matters directly affecting the financial prospects of a company. Last July we

issued a guideline calling the attention of corporations registered with us to their responsibility to disclose material matters on environment where the matters affected the capital needs or earnings of the company. We found in February that while some of the disclosure we received were quite detailed, in many cases we were getting boiler plate in the spirit of the guidelines. In light of that we promulgated for comment the proposed rule amendments on material litigation reducing the amount by which litigation can be said to be material and thus must be disclosed and also providing that suits brought or threatened by governmental bodies against issuers should not be considered "ordinary to the business" and hence not required to be disclosed. We hope that these amendments, if promulgated in final form, will produce disclosure that really reflects the litigation and environmental posture of a company.

Additional revisions of content may not be specific amendments to our forms but rather general guidelines to follow. Moreover, the content should be made more relevant to the kind of issuer whose securities are being sold. This was recognized when the Commission promulgated Form S-7 a few years ago for

issuers who could qualify under a test of longevity in 1934 Act filing, and also Form S-9, for debt securities of companies with high coverage ratios.

The current "hot issue" hearings we are conducting may well result in new forms of disclosure for unseasoned companies. Indeed, in the light of what appears now to be a new "hot issue" boom -- parallel in size to the 1961-63 and 1967-69 eras -- we may be forced into taking action for the protection of investors even sooner than we thought. It appears from the data produced at the hearings that the problems raised in the hot issue market relate more to imperfections in the distribution and aftermarket trading process than in inadequate or inaccurate disclosure in prospectuses. However, certain items of disclosure would give investors a better view of what they are getting into. We are considering requiring a start-up company to discuss its "business plan", its budget for implementation over the next year, a detailed description of how the use of the proceeds of the public offering will go towards accomplishing the plan, and and analysis of the expected markets for the products, including a much improved analysis of competition in the area.

Too many companies merely state that: "There are a large number of other companies in the same business with superior financial resources and better known to the public". It appears to me that such disclosure is worse than worthless in that it calls no attention whatsoever to the possibilities of the failure of a registrant's plan. We may also require an expanded due diligence search on the part of the underwriters, a more detailed analysis of the risk factors in the arrangement, a more comprehensive disclosure of the track record of the management and a discussion of the plan for distribution of the securities.

The hot issue hearings have also dealt with another aspect of the content and relevance question. I have spoken on a number of occasions about the fact that a backward looking prospectus only tells half of the story. Investors do not put up their money solely on the basis of past history. They are always partly sold, and particularly in the new issue area, by verbal assurances about the prospects of the company. Such projections are at least as valuable, if not more so, than the past three year's financial record, particularly if

the company is just starting up. We recognize there is a legal problem for a company to predict its future earnings. We believe, however, that it is possible for companies to make good faith projections of future prospects; after all, analysts make such projections and make research reports on that basis, management estimates do circulate, and trading values do relate to earnings estimates more than anything else. The Division of Corporation Finance is studying the liability and reliability aspects of earning projections and seeking the advice of accountants, financial executives, analysts, and lawyers. We hope to have an opinion crystalized before cold weather returns. We might start by permitting projections on a limited scale, then, on the basis of experience, consider later the notion of requiring them as the British do.

One phenomenon of the 1967-69 hot issue market has always amused me, because it proves that disclosure can't do everything. The SEC had required, in connection with the sale of securities in small unseasoned companies -- or where there was wide dilution from the start or heavy underwriting compensation -- that the front cover of the prospectus contain a legend reading "These securities are speculative".

Experience with this legend proved that it was a far greater inducement to investors to buy into these deals than a warning to them to investigate the special problems connected

with such financings. In fact, some issuers and their underwriters emphasized the legend by putting it in large block type, or with red ink or even catycornered across the page. With a certain amount of sheepishness the Commission retraced its steps and changed to the rubric which still stands, from the "speculative" language to "These securities involve a high degree of risk". Whether this legend will also prove to have been a selling point is one of the questions we hope to have answered by our current hearings.

As a final comment in the content area, I was most interested to see this year that some issuers have begun to put summary statements in the front of their prospectuses which give the high points of the issue. These summaries, although they do present at present a degree of legal risk, are clearly helpful for investors to pick up quick disclosure of securities being sold. In addition, by removing the old ban in our guidelines against the use of pictures in a prospectus, we have seen some rather colorful prospectuses become effective. I am all in favor of turning the 1933 Act prospectus into as readable and colorful a document as it can

be made without becoming misleading. Again, we are moving slowly in this area, but I expect that the problems can ultimately be worked out.

The third and last phase of our disclosure program relates to financial reporting. Everyone knows that the financial statements are the guts of the disclosure document. Everyone also knows that they are also the hardest part to understand. Further, the meaning of financial statements from various companies can be monumentally affected by the choice among a number of acceptable accounting methods.

Disclosure, to be useful, must be uniform. We feel the accounting profession has put a lot of effort into the search for uniformity in accounting standards. It took a constructive step in accelerating this effort in setting up the committee chaired by former Commissioner Frank Wheat.

We are also reviewing our policies in relation to the work of the accounting profession as it recognizes the need for a more concentrated effort and a more swift and effective resolution of accounting standards through the new procedures recommended by the Wheat Committee. As the deliberations of the accountants proceed, the Commission is considering accelerating its requirements for supplemental disclosure on the significance of

different accounting policies adopted by companies, the effect of changes in those policies, the meaning of accounting choices, and the assumptions and methodology of making certain estimates which may be critical to the way in which financial results are reported.

There are two areas that illustrate the importance of adapting our disclosure process to changing developments and changing centers of interest. The tempo and magnitude of the sale of real estate interests to public investors has stepped up enormously. What was previously a locally financed business has emerged as probably the largest user of public equity funds today. Housing, real estate syndication and land development are usual features calling for disclosure. Special characteristics of the kinds of groups that finance these interests, on the other hand, present unusual disclosure problems, such as the relationship between different groups related through a single sponsor. We are in the process of creating a special advisory committee of professionals experienced in this area to guide us in reviewing our disclosure procedures and requirements in the real estate field.

We must update our disclosure procedures to recognize the growing significance of the tax aspects of investments. The tax status and treatment of companies has assumed a greater significance in evaluating the merits of their securities. But beyond that, we have today a big influx of tax shelter packages, and the investment community is turning more of its efforts to selling these packages. They involve real estate, housing, oil, citrus, cattle, farming, equipment leasing, and so on. We are developing working relationships with the Treasury to give investors greater assurance that Internal Revenue policy and tax uncertainties are properly reflected in the disclosures accompanying the offering of this kind of investment.

The fight for effective disclosure is seldom a glamorous one, but the importance of getting accurate and useful information into the hands of investors is so strong and the tempo of change so great that we must keep moving. The areas I have discussed this morning represent more than a beginning, but there is much to do.