TOWARDS SIMPLER MORE EFFECTIVE DISCLOSURE

ADDRESS

BY

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My subject today is not new. Since its inception, the Commission has been striving for more effective disclosure. And, I should add, the most effective disclosure is not necessarily the most voluminous. But the nature and rapidity of change in corporate enterprise in recent years make it necessary for us to reexamine the rules and the standards developed during simpler times to determine whether they are serving the interests for which they were conceived.

The growth of more complex enterprises has been accompanied by a rapidly increasing number of persons who are allocating their savings directly, or indirectly through institutions, to the equity securities markets. In any attempt to solve the problems and meet the needs arising from these developments, a proper balance must be struck between these demands and the burdens on those who will be asked to meet them.

My assignment is to discuss briefly some of the problems and certain proposals advanced to meet them. I start by conceding the obvious--that these problems are not susceptible to easy solutions; and that some of the proposals may not provide the only answers or the best answers. There may be more attractive alternatives of which we are not aware--other approaches which will better answer the needs of the American investor. Quite frankly, it is my hope that, in exploring them here today, you will be stimulated to provide the same help and assistance that we have been so fortunate in receiving from you in the past. The sighs I hear emphasize that we are not embarking on a new venture. Many of you and many of us have been hard at work in assessing possible solutions to the knotty problems we face.

By way of example, as most of you know, we are working with the Financial Executives Institute and the American Institute of Certified Public Accountants, and with individual companies, to develop feasible solutions to problems which spring from the trend of corporate enterprise to engage in a number of distinct lines of business under the same corporate roof--the so-called "conglomerate" companies. The financial information available concerning many of the companies which fit this description does not permit sound analysis of their immediate and potential prospects, of the value and contributions of recently acquired new and different enterprises, and of the performance of management. The studies and other efforts now under way will, I hope, enable us to report substantial progress in this area in the near future. Another example of which you are familiar is reflected in the efforts of the American Institute of Certified Public Accountants to eliminate unjustified--and I emphasize the

word unjustified--differences in the presentation by different companies of essentially similar financial information and experience. And there are many other examples.

The fruits of these efforts, however, will not be fully enjoyed unless essential information concerning publicly held enterprises is readily available to existing and prospective investors in useful and timely form. We are reviewing current disclosure requirements under the Securities Exchange Act of 1934 to determine whether, and the extent to which, the content and timeliness of information required to be filed under that Act can be improved. We are also reexamining the techniques of registration, prospectus delivery and related matters under the Securities Act of 1933 not only to determine whether we are keeping abreast of changes in our economy and in the form of corporate enterprise but also to consider whether our requirements and procedures can be simplified and expedited, particularly for companies subject to the Exchange Act which provide their shareholders with information on a continuous basis. We hope these efforts will improve the quality of the information made available to the investing public and make possible a closer integration of the requirements of the 1933 and 1934 Acts.

Integration of the Disclosure Requirements of the Securities Act of 1933 and the Securities Exchange Act of 1934

Before dealing with current proposals for integration, it is important to restate certain differences in the disclosure requirements and goals under the two Acts and to recall some of the Commission's efforts to integrate them.

The purpose of the Securities Act is to require disclosure of material information to investors at the time of a public offering of securities. The purpose of the Securities Exchange Act is to require disclosure of similar information on a continuous basis by issuers whose securities enjoy a substantial public trading market. The 1933 Act requires that this information be placed in the hands of investors through a prospectus. The 1934 Act requires that the information be filed for public inspection. Substantial information, however, is publicly disseminated annually, pursuant to the 1934 Act or the requirements of the exchanges, in connection with the delivery of a proxy or information statement and the report to shareholders.

Both Acts grant to the Commission broad authority to vary the requirements for different classes of securities or issuers. Each Act, however, theoretically imposes the same basic requirements whether or not registration has been effected under the other Act. Consequently, absent Commission rule-making, the two Acts may require some duplication of information and effort.

With the aid of issuers and representatives of the securities industry, the Commission has, almost since its first days, tried to eliminate unneeded duplication wherever possible. I think you will agree that, for the most part, the Commission has been successful where an issuer registers securities under the 1934 Act at or shortly after registration under the 1933 Act. In such cases and in others where the issuer is subject to continuous reporting under Section 15(d) of the 1934 Act, the Commission has allowed issuers to register securities, under Section 12(g) for trading in the over-the-counter market or, under Section 12(b) for listing on an exchange, by filing a very simple form which permits incorporation by reference to information previously filed with the Commission.

Because this procedure has worked so well, many persons, including the authors of the Special Study of the Securities Markets, have suggested that the Commission adopt a similar procedure for registering securities for public sale under the Securities Act. They argue that, by permitting issuers to utilize the information they have previously filed under the 1934 Act, duplication of effort would be avoided and a reduction of processing time by our staff would be achieved. Parenthetically, I should note that I have come away from many discussions of this subject with the feeling that this latter point is the most significant and, when achieved, would make moot the need for new or different forms or requirements.

The Special Study suggested that it was anomalous to require full compliance with the 1933 Act registration and prospectus delivery requirements by issuers of securities subject to the reporting requirements of the 1934 Act. They pointed to the fact that for 40 days after the offering begins a purchaser of shares registered under the Securities Act must be given a prospectus, whereas a purchaser of identical outstanding securities is presumed to be sufficiently protected by the reservoir of material previously filed under the Exchange Act.

While I do not disagree with the ultimate objectives of those favoring greater integration, I believe this argument overlooks several vitally important factors.

First, there is an essential difference between the efforts involved in, and the purposes to be served by, a "distribution" of securities by an issuer or its controlling persons when compared with ordinary "trading." The Securities Act normally involves the sale of a substantial block of securities through an organized group of underwriters and dealers who in some cases assume substantial financial risks. There are considerable incentives to induce the rapid and aggressive sale of the registered securities. In these circumstances there is a need to provide a mechanism to assure that the investor is not overwhelmed by the specially

induced enthusiasm of the salesman. The '33 Act prospectus, at the least, provides a background of adequate material information in a single document, against which this enthusiasm may be examined and it reveals the special incentives and rewards behind it. This information, required to be presented in relatively concise and usable form, not only allows the investor or his adviser to formulate quickly a judgment as to the merits of the security but also to evaluate the optimistic recommendation of the salesman. While special incentives to the salesman are occasionally available in the distribution of unregistered securities, this is not normally true in the ordinary trading of securities by investors.

Second, the public offering of securities by the issuer frequently reflects or anticipates such a reconstitution of its business as to require an analysis not only of its current position but also of its potentials and prospects. The information necessary to analyze the possible effects of the injection of new capital into the company, the consequent change in its capital structure, and the purposes to which the proceeds are to be put, of course, are not usually available in material previously filed under the '34 Act. To provide the necessary information and, indeed, to determine, in the first instance, the amount and type of securities to be issued, requires the management of the issuing company, in conjunction with the underwriters and assisted by their counsel and the independent accountants, to make a thorough and comprehensive study of the position of the company and where it is heading. The investor obviously needs this information so that he or his adviser may determine whether the offering fits his needs.

Third, we must not overlook the fact that the prospectus is an effective means of achieving wide dissemination of information about the issuing company to all members of the investing public and to the dealers and other professionals who serve them, at a time when important changes may occur in the life of the company.

There are other factors which bear upon the quality and quantity of information actually produced under each statute. I mention these differences, however, not to suggest that the problems are insoluble but to emphasize certain factors frequently overlooked or ignored.

The concept of integration has been discussed recently as if it were a new idea. The opposite is true. The Commission has, throughout its history, considered the possibilities for greater integration of the requirements of the two statutes. And it has employed at least two different approaches, any one or a combination of which may provide a basis for further progress in meshing the requirements of the two statutes.

First, under Form S-14, adopted in 1959, an issuer may satisfy the registration and prospectus requirements of the 1933 Act by use of a merger proxy statement, prepared under the requirements of the 1934 Act to obtain authority for the corporate transaction which was the prelude to the public offering, with a minimum of additional information. This procedure, of course, is available only when the financial statements contained in the proxy statement are current as required by the 1933 Act.

Second, the Commission has made it possible for issuers to omit certain information available by virtue of the requirements of the Exchange Act when they register securities on Form S-8 under the 1933 Act for sale to employees or when they register certain high grade debt securities on Form S-9 for general distribution. And last November we proposed that certain issuers of securities registered and listed for trading on a national securities exchange be allowed to register equity securities on a new Form S-7 which authorizes the omission of certain information required by the general Form S-1. We received a number of comments and criticisms, principally concerning the standards proposed for use of this new form. I hope that we will soon complete our study of them and be in a position to take further action. I should point out, however, that, when we proposed Form S-7, we recognized the desirability and the need to upgrade our requirements under the 1934 Act to provide an adequate source for information proposed to be omitted from Form S-7.

We are committed to a continued exploration of the question whether other improvements can be effected under the 1934 Act as a basis for further simplification of the mechanics of registration under the 1933 Act. It is necessary to note, however, that serious questions arise when information, which some 34 years of experience indicates to be important, is deleted from a 1933 Act prospectus unless, as a minimum, similar information of equal quality and quantity is otherwise readily available to investors in usable form.

Issuers generally furnish information of high quality in fulfilling the requirements of the Securities Act. And they have presented it in a manner which a broad spectrum of investors or their advisers can readily understand and use. This is not always true under the 1934 Act even as to those issuers who have done so well under the 1933 Act.

I must confess that the differences stem in part from the Commission's own requirements and procedures. Generally speaking, the Commission does not now require in reports under the 1934 Act that an issuer periodically restate information previously filed in bits and pieces over an extended period of time; the issuer need only add new information to that previously filed. While this, of course, eliminates problems for the

issuer, it casts a tremendous burden on the public to wade through volumes of material in an attempt to obtain a comprehensive and current picture of the company. In most cases the sheer volume of material, and length of time required to wade through it, make it impossible to draw such a picture. It is questionable whether this procedure meets the needs of investors for complete, accurate and up-to-date information, quite apart from the question whether information in this form is a suitable substitute for that required in a 1933 Act prospectus.

The mere addition of new data to disjointed and unconnected data previously filed raises questions, for example, whether, and the extent to which, financial statements for previous years should be revised in the light of financial statements prepared for subsequent periods and of other information more recently developed. Moreover, where a company acquires or disposes of a large amount of assets, or where it acquires another company, investors may find that they are left without any meaningful way to compare year-to-year operating results. We have improved this situation somewhat by requiring issuers to provide a comparable financial statement for at least the preceding year in the annual report to shareholders. This presented no problem for most companies since they were already providing their shareholders with this information. It did mean, however, that a small minority of companies had to bring their practices up to the standard set by the majority. But this modest improvement does not measure up to the five-year summary of earnings presented in 1933 Act statements. And we have tried to meet the difficulty of trying to obtain from officially filed sources basic information in a form that is useful by requiring that the first annual report to shareholders sent pursuant to the requirements of the proxy rules contain a description of the general nature and scope of the business of the issuer. This description, however, is required only once and is substantially less complete than the more useful description required by Form S-1 under the 1933 Act.

I could continue listing the differences between the quality and timeliness of information required under the 1933 Act and under the 1934 Act, but it would serve no useful purpose. Each of you is familiar with them. These differences do pose questions that demand answers. How can we effectively and reasonably raise the standards of disclosure under the 1934 Act to provide current and reasonably complete information to investors in the trading market? How can we assure that a sufficient reservoir of quality information is available under the 1934 Act to allow issuers to utilize this information under the Securities Act without depriving investors of the information they have a right to expect and which the Congress intended them to have? How can we assure that this information is readily available and in usable form? The proxy statement and annual

report to shareholders generally are well prepared. But, do they provide the proper vehicles to assure widespread dissemination of sufficient information for the prospective as well as the existing shareholder? Have we made full use of modern technology for quick and inexpensive duplication and dissemination of important information? Should issuers undertake to supply copies of officially filed documents to any investor on request? Do issuers need more assistance from the staff of the Commission in preparing their reports? Should the Form 8-K be filed sooner after the occurrence of an important event rather than, as now required, 10 days after the end of the month? Is integration achieved by requiring transmission of 1934 Act reports to investors in satisfaction of the prospectus delivery requirements? May some of the information on file with the Commission be eliminated from the 1933 Act prospectus on the assumption that investors and their advisers can obtain this information if they desire? Are there other alternatives? And what burdens would be imposed on issuers and their officers?

Answers to these questions may provide a basis for closer integration of the 1933 and 1934 Act disclosure requirements and might have important consquences for issuers and their shareholders. First, it might be possible to reduce substantially the processing time for registration of new issues. Second, it has been suggested that it might lead to a special exemption under Section 3(b) of the Securities Act which would allow a control person, or a person who has taken securities in a non-public offering, an opportunity to sell up to $300,000 of securities under circumstances in which he might otherwise be locked into his investment position because registration was too time consuming or too costly for the issuer in the light of statutory requirements for current financial data. Third, it could assist materially those interested in evaluating a company, its management and its operations. This would encourage broader and better markets for the issuer's securities with substantial benefits to the issuer when it seeks new capital.

We do not have the answers to all of the questions I have posed. But solutions must be found to meet the problems without imposing impossible burdens on the companies called upon to meet the developing requirements of investors and their advisers as they seek to reach decisions in an increasingly complex economy and world. We are certain that you will assist us and others who are engaged in this endeavor. And we pledge our cooperation in reaching the necessary balance.