DISCLOSURES UNDER THE SECURITIES ACTS AND THE FINANCIAL PRESS

Address by

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Securities and Exchange Commission

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A few weeks short of one year ago, I learned of the organization of your Association and that you had held your first meeting here in New York. In June, I participated in the program of the 45th Annual Conference of the National Association of Accountants in Washington and commented upon a number of developments which I considered to be significant to the well-being of our securities markets. I don't know whether you appreciate being called a "development," but I am very happy to have the opportunity to say to you directly today what I observed to the accountants nearly a year ago--

> "Recently it came to my attention that a new organization has been formed which, in my opinion, has a real potential for public service. I refer to the recently organized Society of American Business Writers. This group, which was originally proposed some four or five years ago, is reported to have ninety charter members representing leading publications throughout the country. In my judgment, this group, which named as their first president one of our leading financial writers [one who within the past few days has been honored with a Pulitzer prize], should be encouraged and supported."

My colleagues and I continue in that belief. Further, I can predict with conviction that your opportunities for growth and development, and the assertion of an ever-broadening influence for good in the financial sector of our society, should know no limits. You can fill a great void and perform a vital role which, in my view, has called for attention for many years. Under our system, this role is one which belongs peculiarly to private enterprise. It should be performed continuously, alertly, honestly, objectively, expertly and with great discernment. It is a role which is now denied to government--on the Federal level. Experience has established the soundness of the legislative decision in this respect made a generation ago that that denial should persist.

The fact of the matter is, however, that you and we at the Commission are engaged in essentially the same business. Now, I am sure that the press as an institution has not generally identified itself with "government" or "governmental functions." More often than not, the press seems to assume the posture of a

critic of government, its methods, procedures or objectives. In the case of our particular, rather limited sphere of "government," although you may criticize our methods or procedures, you are bound to be in favor of our basic objectives, since they are essentially the same as yours. Your business and ours is that of securing and channeling into the public domain adequate, accurate, understandable, honest facts about our securities markets and the merchandise for the service of which those markets exist.

But there is a vast difference in our functions--our powers, our procedures, our immediate objectives. There are greater opportunities in your role and potential role than in ours. You have great mobility in choice and range of subject matter; a freedom of expression denied us; an ability, indeed a duty, to evaluate; to comment; to recommend; to object; to editorialize, to urge--to condemn. You have all the power of the press to marshal fact and opinion, to persuade, to shape and give direction to public taste and standards. We, on the other hand, have the duty and power to call for disclosure of facts--business facts on particular subjects or subject matters. But we must not speak to the merits, except as that might be considered to be reflected as a species of by-product of our efforts to cause particular disclosures or disclosures in a particular way.

We can subpoena. In some limited areas we can act in a quasi-judicial capacity. In others we can and at times must seek judicial assistance to compel or prevent. We cause the production of what we hope and believe to be adequate material basic facts pertaining to business matters. We are like the manufacturer with a fine plant--skilled work force--an excellent product for which there is a public need--and only a limited facility for wholesale or retail distribution.

In many areas and on frequent occasions, the business writers of this country can and should become a medium by which raw data provided by our procedures under the requirements of law become the subject of enlightened and informed discussion for the benefit of the market place--our investing public. The New York Times, in a recent editorial comment referring to the Pulitzer prize in the field of business writing, drew attention to "the increasing significance of a serious but less spectacular side of American reporting." It may or at times may not be spectacular--but it can be exciting and stimulating.

The need for the sort of service you can perform is all the greater because of the frequent complexity and subtlety of subject matter in the case of many past or prospective business transactions reported pursuant to our requirements. The importance of the potential for your role is particularly emphasized when history and tradition and the status quo are challenged by competing interests in the market place. The same may be said when new developments emerge which predictably will cause shifts in the relative positions of competing interests or changes in the ways in which business is done.

Business or financial transactions of companies illustrate the first category: tender offers, exchange offers, reorganizations, recapitalizations, bankruptcies, mergers, acquisitions, spin-offs, joint ventures, public financing or private placements for a multitude of purposes.

The financial writer's operating base with respect to this category has been broadened considerably by the 1964 amendments to the Exchange Act. Until April 30 of this year, we received annual and periodic reports which included certified financial statements from listed companies and those over-the-counter companies which had sold securities to the public in substantial amounts under the Securities Act of 1933. Under the statute as it was prior to the amendments, we were receiving reports from approximately 2200 issuers of listed securities, from about the same number of over-the-counter companies which had financed under the Securities Act, and 530 investment companies, a total of roughly 4900 companies. The amendments will subject--as near as we can estimate--another 2900 companies to the reporting and proxy requirements of the 1934 Act over a two-year period beginning with April 30 just past. In total, these several categories of over-the-counter companies, including the banks which will report to the Federal banking authorities* and the insurance companies which are subject to special provisions tied to state law, will ultimately represent, it is estimated, close to 90 per cent of the business done in the over-the-counter market. This is a significant broadening of the informational base for all persons concerned with our securities markets--

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*Federal Reserve Board, Comptroller of the Currency, and Federal Deposit Insurance Corporation.

broker-dealers and business writers in particular. As to many of these companies, you will for the first time not be dependent upon the corporate handout or the speculation of those claiming to have access to special sources of information. These companies will now be required to supply for public inspection at our offices reports containing information about their business affairs. Of particular significance is the fact that historical, financial and operating statements of these companies will be subjected to the scrutiny and comment of independent certified public accountants. Further, they will be required to furnish annual reports to their stockholders pursuant to our proxy rules. Officials and large holders (10%) now will be required to report their holdings of and transactions in the equity securities of their companies.

In the second category, for example, I would place a subject such as the third market in listed securities. The Special Study directed attention to this phenomenon of the financial world, and in doing so, I think, quite unintentionally, dramatized it. The third class would embrace such subjects, by way of illustration, as the impact of electronic data processing, regional versus major exchanges, listed versus over-the-counter markets, banks versus mutual funds.

This leads me to an observation which I have made on occasion and which I firmly believe, although some may differ, that in the long run, market prices reflect the judgment of professionals. Tulip or uranium or bowling manias may at times seem to disprove the proposition, but markets don't persist on manias. The cold consensual analysis of the professional ultimately makes or breaks a market. The views and comments of the respected knowledgeable financial writers--those associated with the press as well as those affiliated with the financial services, investment houses, banks and others are vital components of that consensus.

Although this is a field of great opportunity and one that calls for increasing participation by a growing, knowledgeable, perceptive membership, it also is one full of rather awesome responsibilities and not without its hazards to the journalist. I will venture a single observation as to each.

In a sense, I suppose, the responsibility is no greater or less than that borne by writers concerned with other aspects of our society--the risk that the best intentioned writer may unknowingly or inadvertently mislead the reader. Since the subject matter of the financial writer may well involve volatile markets and other people's money, the dollars and cents consequences to the public investor or speculator, however, may be much more direct and significant.

As to the hazards--I mention only one--in the securities business, particularly in that part of the securities business having to do with the continuous auction market of the stock exchanges and the ticker tape, inspectors occasionally encounter a practice known as "painting the tape." It may be defined as the use of the exchange tape as a means toward a manipulative end; more specifically it is characterized by a sudden burst of heavy buying or selling reflected on the tape, which is intended by the trader or speculator to create an appearance of genuine trading activity and thereby attract public interest and action.

I believe that one of your greatest risks--if I may coin a phrase--is that you unintentionally will become the instrument of those who wish to "paint the press." In this connection, if you have not read Chapter IX of the Special Study of the Securities Markets, Section C, Corporate Publicity and Public Relations, I urge you to do so.

Some of you undoubtedly will be inclined to specialize somewhat if you happen to be interested in particular aspects of the financial scene. Others may ignore the activities of companies and concern yourselves with broader aspects of the markets and their mechanisms. Always there will be some more attracted by legal, ethical, or philosophical problems which seem continuously to be with us. One of the advantages of an organization such as your is the opportunity for stimulating discussions, the evolution of standards of approach and conduct and, even though in a sense you may be competitors, the establishment of a clearing house for legal and economic matters of interest to your membership and pertinent to whatever objectives you may determine to pursue.

One of the services you could perform for your own benefit and guidance (as well as for your audience) would be to work out some arrangement by which significant legal or other

action by the governmental agencies concerned with financial matters--including the Commission--or by the courts or Congress could be brought to the attention of your membership in an orderly and organized way. For example, the Commission is a focal point for much that occurs in corporate financial matters in this country. What it does and says can be of help to you if you are organized to use it. There really is no reason why after thirty years there should be very much confusion among financial writers as to the scope of our activities and authority, what we do or how we do it. And yet I suppose there is no reason either why the busy financial writer, far from the center of action in some matters, should be expected all by himself to keep abreast of the Commission's work.

Even among those close to the main stream of financial matters there are times when what we do apparently strikes observers as being contrary to the very interests we exist to serve. For example, there is more than a little irony in the charge sometimes heard that the SEC--committed as it is to the philosophy of disclosure--by its actions has encouraged issuers to withhold information from the press, thereby keeping important news from the very people to whom the information should be made available. The charge is a serious one, and has been made without malice by conscientious and thoughtful journalists.

I do not believe that the charge really bears up on analysis. Those quite limited strictures which the Commission has imposed on the free dissemination of information by issuers and broker-dealers are not only required by the purposes and provisions of the 1933 and 1934 Acts, but also we hope represent a proper balance between the interests of free expression, on the one hand, and legitimate regulation of the securities markets, on the other. Since this matter is of obvious concern to financial writers, I would like to discuss it in some detail.

Under distribution practices for new or secondary issues which existed prior to the enactment of the Securities Act, underwriters, brokers and dealers and their customers, so far as Federal law was concerned, had no choice but to rely upon whatever information an issuer might choose to make available for their consideration. Many commitments of great magnitude thus were made blindly without adequate information. Public interest could be stimulated by premature publicity by issuers, promoters and

underwriters. There was no way of determining the degree of reliability of the information or rumor so disseminated. This situation was found by the Congress to be a threat to investors and detrimental to the public interest, and the Securities Act of 1933 was one of the results of that determination.

It was the clear intent of Congress to change some of the characteristics of this distribution process. Brokers and dealers and the public were to be protected from the pressures upon them to make commitments without adequate and reliable information being made available to them by the seller in timely fashion. The stated purpose was to make certain that the information necessary to permit an informed and unhurried appraisal of the security offered be made a matter of public record by the issuer and underwriter prior to any solicitation of dealers, or the investing public. In furtherance of these statutory purposes, Section 5, the very heart of the 1933 Act, flatly prohibits any activity by issuers, underwriters or dealers designed to further the public offer or sale by them of securities required to be registered under the Securities Act or to stimulate offers to buy from brokers, dealers and investors prior to the filing with the Commission of a registration statement.

After a registration statement has been filed, but before it becomes effective, oral offers for sale may be made, but a written offer may be made only by a statutory prospectus. This includes the preliminary prospectus filed by the issuer as well as the summary prospectus provided for in our rules. In addition, the so-called "tombstone" advertisement permitted by Section 2(10) and Rule 134 may be used. No sale may be consummated legally, however, during the period prior to effectiveness of the statement.

After the registration statement becomes effective, written offers may be made otherwise than by the statutory prospectus, but only if accompanied or preceded by the final prospectus.

The term "offer for sale" is defined in the Act to include "every attempt or offer to dispose of, or solicitation of an offer to buy, a security for value." The broad scope of the definition is evident. These carefully chosen words reflect the Congressional mandate that the term "offer" not be narrowly limited to communications which include express words of "offer"

or which refer specifically to a security. The Act was designed to put an end to any selling effort and to the use of all sales literature and publicity by issuers, underwriters and dealers intended for this purpose prior to the filing of a registration statement. The Congress was quite aware, as we have been, that a very effective public sales campaign can be carried on, even though express words of offer or sale are not employed.

It is at this point, however, that a very practical problem arises, calling for a very practical distinction to be made. The prohibition against prefiling offers, thus broadly defined, has never been considered by the SEC or the courts to make unlawful the bona fide dissemination of normal corporate information to the public, if the information is not a part of a selling effort; in other words, if the circumstances do not suggest evasion and sharp practice. Whether a particular item of corporate publicity or institutional advertising constitutes an offer to sell made unlawful by the Securities Act can of course be a difficult question.

The distinction is a vital one, and is not a matter of mere form. Like so many other sophisticated legal distinctions, it can be made only by consideration of all the facts and circumstances of a particular case. Factors such as intent, knowledge and time are important considerations in determining whether an item of publicity will in a particular situation be regarded as an attempt to dispose of a security within the meaning of the Act. Accordingly, the Commission has never believed it appropriate to try to formulate a rule-of-thumb definition in this area; the approach has instead been on a case-by-case basis. But as the body of case history has evolved, I think that certain principles or guides have become apparent.

First, with respect to an issuer or its officials or employees, the Commission has consistently stated that an issuer may continue to advertise its products and services without interruption. An issuer may also send out its customary quarterly, annual and other periodic reports to security holders, and it may publish its proxy statements, send out dividend notices and make announcements to the press with respect to important business and financial developments. For example, the announcement of the receipt of a contract, the settlement of a strike, the opening of a plant or any similar event of interest to the community in which the business operates has never been prohibited.

Not only does the Securities Act permit such activity, but listing agreements and other requirements of the principal stock exchanges require it in certain instances, as do certain of the provisions of the Exchange Act. This flow of normal corporate news, unrelated to a selling effort, is natural, desirable, and entirely consistent with the objective of disclosure to the public which underlies the Federal securities laws. This does not mean, however, that purported news items which tout the companies' securities or which dwell upon those financial aspects of the business ordinarily associated with the sale of securities would be viewed in the same light. Even so-called institutional or product advertisement might sometimes be viewed with concern if timing and content indicate that its real purpose is to draw attention to the issuer's securities and thus condition the market for an offering in progress or shortly forthcoming.

The difficulty for an issuer generally arises from the publication of special brochures, press releases and speeches dealing with the prospects of the issuer at or about the time a registration statement is to be filed or become effective. When, shortly before the filing of a registration statement or during the pre-effective period, public communications of various sorts begin to emanate from issuers or underwriters which discuss in glowing and optimistic terms such aspects of a business as its finances, its earnings, or its growth prospects, stressing the favorable over the unfavorable, a question naturally arises whether in fact a campaign to sell securities has begun. Experience has shown that when particular difficulties in this area arise, they frequently occur because of the publication of valuation data or projections of future net income or dividends and other material which are normally considered to be objectionable in a registration statement.

The question has been asked whether the Commission considers that a broker-dealer must avoid giving out any comment or advice to its customers and others concerning an issuer whose securities are to be distributed in a registered offering in which the broker-dealer will participate. We do not take that position. The Commission believes that the firm ought to discharge what it considers to be its duty and obligation to its customers by reporting on and advising concerning facts significant to the business of the issuer. When a firm knows, however, that it will participate in a certain offering subject to the Securities Act, it seems equally obvious that the timing and content of the

advice thereafter given its customers through reports and brochures will determine how these documents must be viewed in relation to the forthcoming offering and the provisions of the Securities Act.

Perhaps it would help to give you an example of prohibited prefiling activities. The Arvida case was a landmark in this area. As many of you may recall, a private company was formed in 1958, called Arvida Corporation, to which the principal promoter transferred large tracts of Florida real estate. This action was described in a press release, published in some Florida papers on July 8, 1958, which simply announced the formation and purpose of the Corporation. Thereafter, negotiations with various financial concerns culminated in an understanding, arrived at on September 18 of that year, that certain outstanding Wall Street houses would underwrite a public offering of Arvida common stock. Another press release was then issued and a press conference held, as the result of which wide publicity was given to the future plans and projects of the Corporation, as well as to the prospective public sale of the stock through the underwriters. This release read like a letter a distributor might send to a prospective purchaser in an effort to persuade him to invest in the enterprise.

An investigation by the Commission's staff revealed that within two business days after the publication of this release, "expressions of interest" totaling over $500,000 were received by broker-dealers other than the underwriters. All of the indicia were present of the beginning of a country-wide distribution by security houses which normally follows the filing of a registration statement. The important point is that no registration statement had been filed, and neither the SEC nor the underwriters had been given the opportunity which the law plainly states they should have to review the information required by the statute to be supplied for the benefit of the investing public prior to the beginning of a public selling effort. I might add that the information contained in this release and its manner of presentation were not recognizably consistent in many respects with the content of the registration statement and prospectus subsequently filed with the Commission.

Judging the activities and communications I have described in the light of all the circumstances, it seems clear that they were, and were intended to be, part of an effort to

promote the development of a buying interest on the part of the public in a security and thus clearly the beginning of a sales effort. If, in fact, activity such as was involved in the Arvida case were to be permitted, it would be proper for issuers and underwriters in any case to create a demand for a security and substantially accomplish its sale before the true facts were revealed to the public in proper form. This result would obviously be contrary to and defeat one of the fundamental principles and objectives of the Securities Act.

If a particular offering is "newsworthy," as it was claimed to be in the Arvida case, it increases the possibility that publicity activities may involve an illegal offer to sell. It is not at all difficult in these cases to generate speculative demand by incomplete or misleading publicity and thus facilitate the distribution of securities at inflated prices. The fact that extra caution must be exercised by issuers, underwriters and participating dealers in such instances may explain why it has been said that the efforts of the Securities and Exchange Commission to administer the statute in some way constitute an infringement on the freedom of the press. This of course is not the case.

The Commission commented on this subject in its opinion* in the broker-dealer proceeding which arose out of the Arvida incident. Two passages from this opinion are of particular interest to this audience and are worth repetition on this occasion:

> "The principal justification advanced for the September 19 release and publicity was the claim that the activities of Mr. Davis, and specifically his interests in Florida real estate, are 'news' and that accordingly Section 5(c) should not be construed to restrict the freedom of the managing underwriters to release such publicity. We reject this contention. Section 5(c) is equally applicable whether or not the issuer or the surrounding circumstances have, or by astute public relations activities may be made to appear to have, news value.

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*38 S.E.C. 843, 852 (1959).

"It should be clear that our interpretation of Section 5(c) in no way restricts the freedom of news media to seek out and publish financial news. Reporters presumably have no securities to sell and, absent collusion with sellers, Section 5(c) has no application to them. Underwriters such as registrants are in a different position; they are in the business of distributing securities, not news. Failure to appreciate this distinction between reporters and securities distributors has given rise to a further misconception. Instances have arisen in which a proposed financing is of sufficient public interest that journalists on their own initiative have sought out and published information concerning it. Since such journalistic enterprise does not violate Section 5, our failure to question resulting publicity should not have been taken as any indication that Section 5 is inapplicable to publicity by underwriters about newsworthy offerings. Similar considerations apply to publicity by issuers."

The same problem exists in connection with the solicitation of proxies, except that here the question with respect to such material is whether it is reasonably calculated to result in the procurement, withholding or revocation of a proxy. Section 14(a) of the Securities Exchange Act provides that proxies may not be solicited with respect to a security registered under that Act except in accordance with rules adopted by the Commission.

I have also heard comment that the Commission's proxy rules in some manner cause issuers to delay disclosure of significant corporate developments. This should not be the case. The proxy rules merely require that soliciting material must contain certain minimum information which the Commission has determined is necessary for an informed vote by shareholders. The rules further prohibit the use of false and misleading information in connection with the solicitation of proxies. Where the information is to be sent to shareholders, it must be filed with the Commission for our review before mailing. However, if the soliciting material is in the form of speeches, press releases or radio or television scripts, they may but need not be filed with the Commission prior to use, although definitive copies of such material must be filed with, or mailed for filing with, the Commission not later than the date such material is used, and should comply with the disclosure standards of the rules.

Questions regarding whether brochures, press releases, speeches or other corporate publicity may be proxy soliciting material arise most frequently where there is a contest for control of an issuer, or some proposal of major significance is before the stockholders for action; e.g., merger or recapitalization. In a contest for control, persons other than management who wish to solicit proxies are supposed to file certain information with the Commission identifying them and their interest in the issuer and the contest or other matter at least five days before beginning soliciting activities.

It has been suggested on occasion that companies might drop their customary meetings with security analysts on the ground that such meetings might lead to favoritism. I see no statutory basis for such suggestions. Except where there is an impending offering of securities required to be registered under the Securities Act or a proxy contest subject to the Commission's proxy rules, we have never attempted to discourage discussion by management of matters pertinent to an issuer's operations and programs. In fact, the listing agreements of the major exchanges require prompt public disclosure of material developments. We agree with the financial analysts that such a discussion by a person intimately familiar with the issuer and the industry can be very helpful to investors. Naturally, we expect, and I assume the audience expects, that such discussions will be based upon solid evidence warranted by existing circumstances. It is only where the information which is presented is false and misleading or would operate as a fraud or deceit upon investors or material information is wrongfully withheld or there is some wrongful manipulative activity that the prohibitions of the Securities Acts come into play.

I think the financial community has become increasingly aware in recent years that even though misleading publicity or the deliberate withholding of important corporate information may not attract the attention of a regulatory body, there is always a possibility of an expensive suit for damages when the true facts eventually come to light. As the New York Stock Exchange has so well stated in its company manual with respect to the latter, there are few things "more damaging to stockholder relations and the general public regard for corporate securities than information withheld, whether by inadvertence or by policy." This is not difficult to understand when, as a result of such

inadvertence or policy, investors may be paying more, or selling for less, than securities are worth at the moment on the basis of the known but unannounced developments.

The one great problem which has always confronted us and will continue to concern us is the matter I mentioned earlier--the fair distribution of information and the concomitant broadening of the membership of an informed public. In this country we are committed to the principle of wider public ownership of corporate securities. Our growth will require even further growth and dispersion of security ownership. It seems clear that as the security-owning population increases, the need for and dependence upon fair, honest, accurate financial reporting and analysis likewise will become more critical. Yours, in truth, is a growth industry.

Your organization as an organization arrived on the financial stage a little later perhaps, but at a time of great change and great opportunity. The Special Study of the Securities Markets for the first time in thirty years has provided an authoritative inventory of subjects which call for analysis, scrutiny and discussion. These should not be left solely to government or industry. Many of them involve public issues and a public interest which deserve widespread public discussion and understanding. Also, this seems to be a period of ferment and change in the financial world. Our markets, I believe, are good ones--there really are none better. And public participation in them surpasses that in any other society. But the growth of both involves pressures for change which must be appraised. When the public interest calls for changes, means must be found to accommodate those pressures.

In the February issue of Fortune there appeared a short paragraph in the words of Mr. Luce--I wish to borrow it and tamper with it just a little:

> "I would cite at the start the proposition on which FORTUNE was founded--that all business is vested with a public interest. And since it is, like no other capitalistic business anywhere, ever, American business in the twentieth century has been open to inspection. It is not only open to inspection by all manner of

> government agencies including the Antitrust Division and the Securities and Exchange Commission. It is also open to the inspection of journalists, and in this FORTUNE has played a leading role."

For my purpose this morning, I would change the last sentence, and I'm sure Mr. Luce wouldn't mind--and in this you must hereafter play a leading role.