REMARKS OF

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THE FUTURE FOR INVESTOR INFORMATION

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Introduction

It is a pleasure to be here today at your first national conference and have the opportunity to discuss with you some of the activities of the Securities and Exchange Commission. I understand that your program thus far has been most successful. Conferences of this type can do much in furthering everyone's knowledge and appreciation of what protections are available for this country's more than 31 million individual shareholders.

There now exists a comprehensive scheme of federal regulation for the protection of investors which encompasses such diverse activities as the national stock exchanges, virtually all broker-dealers, investment advisors, mutual funds, industrial companies and public utility holding companies. The keystone to these statutes is the concept of full and fair disclosure. Disclosure in varying forms is found in all of the statutes administered by the Commission but perhaps has its greatest application in the very first of these, the Securities Act of 1933. It is here I would like to begin since any understanding of the present federal standards for investor information as well as the future for such information requires looking back to the circumstances which contributed to their enactment. When the Congress undertook, in 1933, to restore investor confidence which had been so severely shaken, several approaches to regulation were open to it and it was called upon to decide how best to protect public investors and at the same time foster the growth of corporate enterprise. Not only had individuals lost enormous amounts of money in the stock market crash but legitimate enterprises were faced with the critical problem of being unable to raise needed capital due to investor's skepticism. I might add there were good reasons for being skeptical. At the Congressional hearings, it was shown that as much as one-half of all the corporate securities issued during the 1920's were worthless.

Congress sought to restore lost investor confidence by the enactment of securities laws which required that necessary and relevant information be made available to investors, both present and prospective, on which to base their investment decisions.

On the basis of this information the investor could make a realistic appraisal, whether he wished to buy or sell the company's securities. The Congress also decided, and I believe correctly so, that the federal government should not have the authority to pass upon the merits of a particular company. Once the disclosure requirements are met the individual can decide for himself whether a particular security is suited for his needs. The Securities and Exchange Commission was given the responsibility to see that the appropriate information was placed in the hands of investors and to regulate the securities markets.

I have always thought it interesting, in looking at the history of our statutes, to find that the disclosure features are not unique and that they are patterned largely after Acts of the English Parliament. We find, for instance, that a committee, chairmanned by Gladstone, made an historic report to Parliament in 1844 which contained the following language: "periodic accounts, if honestly and fairly audited, cannot fail to excite attention to the real state of a company and by means of improved remedies parties to mismanagement may be more amenable for acts of fraud and illegality." As a result of this report England took the first statutory steps to require compulsory disclosure by companies selling securities to the public.

Another committee which gave direction to the English Companies Act of 1900 and which had observed the workings of previous Companies Acts made the following statements:

> It is therefore of highest importance that the prospectus upon which the public is invited to subscribe shall not only not contain any misrepresentation but shall satisfy a high standard of good faith.

> It may be a counsel of perfection and impossible of attainment to say that a prospectus shall disclose everything which could reasonably influence the mind of an investor of average prudence. But this in the opinion of your Committee is the ideal to be aimed at, and for this purpose to secure the utmost publicity is the end to which new legislation on the formation of companies should be directed.

The most significant single incident which gave impetus to the enactment of the English statutes took place in 1720, during a period of widespread speculation. The particular company involved was called the South Sea Company and was fortunate enough to have as its governor King George I. This company was organized to trade with South America and the Pacific Islands. In a tremendous surge of activity, the securities of the South Sea Company rose in price from £ 128 in January of 1720 to well over £ 1,000 in July, and then back to £ 125 in December. It is interesting to note in the history that the Directors of the South Sea Company unloaded £ 5 million of the stock shortly before the bubble burst with its resultant ruin of many thousand of investors.

The drafters of our 1933 Act, who referred at length to the English legislative history, made the following observation:

> Fair play at the start is most essential. The prospectus is the basic appeal to the investor's pocketbook. The rationale of the Securities Act is insistence on candor and completeness in making this appeal. It may be ingenious to deem truth an automatic protection against greed and credulity in investors. Much more could be done in governmental oversight of the mechanism of capital investment. But to

> compel the light now demanded by the Securities Act in places often consciously darkened is merely to require the elementary basis for knowledge before asking people to invest (their) savings...

In passing the Securities Act, Congress went into some detail in Schedule A of the statute as to what information was to be elicited. Schedule A includes such essential items as a requirement for disclosing the general character of the issuer's business, use of proceeds, remuneration, requirements as to financial statements and like information. In addition to these statutory requirements, the Commission was also authorized to request "such other information" as may be determined to be "necessary or appropriate" in the public interest. In enacting the Securities Exchange Act the following year the Congress again provided guidance as it had the year before as to what type of information was required to be furnished. It also granted the Commission broad discretionary authority to require certain other information be furnished investors and to insure fair dealing in securities. In short, it might be said that what Congress really did in 1933 and 1934 was to say to the Commission "Commission, the task before you is to see that the investors have the information they need in order to make informed decisions. Go ahead and see that they get it."

In exercising these discretionary powers in the disclosure field the Commission has ever since its creation been doing what might be called a balancing act. It will be engaged in that act as long as it exists, for that balancing function is inherent in the job that Congress gave us. We must always weigh the utility and the materiality to investment decision of some particular type of information against the burden that a requirement that such information be disclosed would impose not only on business enterprise generally, but on individuals, like yourselves. Balancing these considerations is a difficult job. We need all the help we can get. Even with it we would not expect to please even fifty percent of the people fifty percent of the time.

Many believe that the Commission asks for too much information and that some of what we now require is of dubious relevance to the investment process. But most securities analysts and many people in other areas of the investment public fault us for asking for too little, for being satisfied with what they deem to be inadequate material or failing to supply them with this key ratio and that crucial fact.

As I have had occasion to mention before, the two key points to remember about the operation of the Commission's discretionary powers under the disclosure provisions of the securities laws are these:

1. Securities law is living law. What we ask for, what we deem essential and the degree of detail that we seek, change from time to time in the light of changes in the climate of investor opinion, changing techniques of security analysis, the progressive evolution of the art of accounting (I would hesitate to call it a science), and the lessons of economic history.

2. Absolutely essential to the performance of the Commission's job in the disclosure field are the suggestions it gets from the public, the bar, the accounting profession, the securities industry, and the business community. When you tell us what you think our rules ought to say and what our forms ought to ask for, you may often be thinking of your own particular interest. But you are also rendering an extremely valuable service to the broader public interest.

We are anxious to find areas where improvements can be made. As you are no doubt aware, very recently we adopted amendments to various registration and reporting forms to require additional and more timely disclosures. While we concentrate our efforts on improving our disclosures, we are also anxious to simplify our procedures for complying with them. We are not always successful, however, and I thought today I might read to you two letters from a lawyer which were received by one of the Commission's Regional Offices some time ago. The first letter reads as follows:

> Dear Sirs:
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> Mr. John Smith, president of Pond City Auto Auctions, has handed me your letter of January 12 to which please refer.
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> Now I set up the corporation for these fellows. They have bought themselves a lot and are aiming to put up a place where used cars are auctioned off.
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> The boys' intentions were to sell stock only to used car dealers. I know this for a fact, because I set in on several of their meetings when they started the corporation last September. Of course, I suppose they could sell stock to the public if they took a mind to. There is nothing in their charter forbidding it.
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> Now I frankly tell you that I am a country lawyer. There are a dozen lawyers in this town, and I would not give two cents for what all of us put together know about Federal law. The reason is that each one of the regulatory or administrative agencies of the govt. has got its own books of rules and regulations and if a lawyer here had them he would be needing a barn to put them in, and he would be bankrupt from buying them. So, most of us gave up on Federal law long ago. All I've got is a $3

book on bankruptcy. If some poor fellow comes in with a Federal problem, I tell him to write his Congressman. There may be a copy of the Securities Act of 1933 in this town, but I don't know who would have it, and I sure don't.

So, if the Pond City Auto Auction boys are doing something you don't like, you let me know what it is and I will tell them to quit it.

I can't figure how you ever even heard of this outfit. I think their competitors must have written to you. Maybe you could also check on their competitors.

Yours,

The Commission's Regional Office, by return mail, attempted to explain our registration requirements and enclosed explanatory materials concerning them and received the following in reply:

I thank you for your letter of January 29.

It <u>does</u> appear that the stock offering might not have been entirely intrastate, and that therefore registration is required. I have wended my way through all the material you sent me, and I think I fairly comprehend the substance of Release Nos. 4434, 4554, 4450, 4470, and the Securities Act of 1933. However, I must confess that the "General Rules and Regulations" is the most incomprehensibe document that has ever come to my hand. When I graduated from law school, I got the highest grade on the state bar exam. I have an I.Q. of 137, and I still can't read this [damn]

thing and make any sense out of it. Couldn't you just send me some blank forms to fill out? Then we could do business.

Yours,

While we may never come to the point where we can use blank forms we can simplify our procedures for compliance and we are trying to see whether all this information can be put in a form which can be more readily understood by the investing public.

Looking first at prospectus disclosure, it can readily be said that the Commission takes great pride in the evolution of the prospectus into a document that is widely regarded as being of very important and useful value. Over the years there have been numerous improvements made in prospectus disclosure. Yet this should be no reason to rest here. Recent years have seen broad changes in such areas as the line of business reporting requirement and the use of simplified registration forms for certain types of companies. The line of business reporting requirement provides greater in depth information to the investing community on companies with more than one line of business. As you are no doubt aware, we now require disclosure in Forms S-1, S-7 and 10 and most recently in Form 10-K of each separate material line of business, including information on the approximate amount or percentage of total sales and operating revenues as well as the portion of gross income contributed by each material line of business. The forms specify percentages as tests of materiality in order to assist those preparing the forms. These requirements may require more work and more detailed disclosure. However, all the changes in the reporting requirements we adopt are not of that nature. The other recent development I mentioned, Form S-7, was enacted in an effort to lessen the load of reporting requirements by allowing a simplified form of registration statement for certain well-established companies. We hope to continue our efforts to improve prospectus disclosure and to make available shorter and more simplified prospectuses.

Through the years efforts also have been made to achieve a more readable prospectus, and we are trying to improve on the successes so far. Too often we find prospectuses are written in language that is too technical for the average individual investor. The sheer bulk of the information furnished has often caused investors to refrain from reading the prospectus. This type of disclosure can only impair its usefulness as a disclosure document and we will be looking for means to eliminate unnecessary verbosity and complexity. To assist readers of long prospectuses, it has been suggested that a guide be used at the beginning of a prospectus whose text exceeds ten pages in length. We are not unmindful of the difficulties inherent in summarizing all necessary information. However, such a guide might serve as an expanded table of contents to enable readers to obtain a quick understanding of the information contained in the prospectus and be a directive to the location elsewhere in the prospectus where fuller information on each subject is found. We would welcome the views of organizations such as yours on this suggestion or any other suggestion to improve the quality of prospectuses. In considering such suggestions, however, we should all bear in mind that prospectuses are read both by financial analysts and by individual investors alike.

As I mentioned earlier, in conjunction with our efforts to improve upon the quality of the disclosure and expand upon the readability of prospectuses, we are seeking to make more readily available the use of shortened forms of registration statements. As we continue to learn from the use of the Form S-7, we hope to be able to relax the restrictions on the use of this form so that more and more companies will be able to use it. The use of such form at present is restricted to the registration of securities to be offered for cash by certain companies having established records of earnings and stability of management and business. We are considering a proposal to broaden the class of companies to which this form is available. It is proposed that the form be made available to companies whose sales or gross revenues and net income are not sufficiently large to qualify them for use of the form

under present requirements. Hopefully, this can be accomplished without sacrificing investor protection, and thus reduce some of the work of persons who prepare prospectuses. As a further benefit, some of the time now necessary for the Commission's staff to review filings of companies to whom the forms would be made available could be devoted to more pressing matters.

We are also considering other types of shortened registration forms. Subject to certain conditions in each case, it is presently contemplated that a greater abbreviated form of prospectus might be appropriate (1) for certain secondary offerings of stock exchanges, (2) for reporting companies to deliver on the exercise of publicly-held warrants, and (3) for stock to be issued on converstion of publicly-held securities of an affiliated corporation. In each of these cases our consideration of the use of a shortened registration form questions the benefit to be gained by the delivery of a full prospectus. It is felt that the shortened forms will serve equally well the purpose of protection of investors while at the same time ease the burden on those who must prepare the information.

Turning now to disclosure requirements for periodic reports, one cannot emphasize too strongly the importance of corporate disclosure for companies with securities already outstanding. Information periodically provided about a company's affairs which is material to investment decisions is of crucial importance when we consider the enormous increase in the investing public which is continuously trading in securities -- from 6½ million shareholders in 1952 to 31 million at the beginning of this year. Recent proposals of the Commission for amendments to the periodic reports reflects this increased emphasis. The thrust of theproposed changes of the rules regarding periodic reports is quite broad and covers many areas. Inherent in these proposed rule changes is the feeling that their importance is dependent upon their accuracy and adequacy, the promptness with which they are filed, and the breadth of their dissemination. It is not

intended that the Commission be a mere depository for this information where only a few persons have access to it. The information is to be made available for a wide audience and should be of worthwhile value for all investors.

I can briefly tell you the steps the Commission has recently taken. We have adopted amendments to Form 10 and Form 10-K and adopted a new quarterly financial reporting form, Form 10-Q, as well as an amendment to Regulation S-X which sets requirements as to the form and content of the statements of sources and applications of funds required in Forms 10 and 10-K.

Forms 10 and 10-K were amended to improve the quality of the disclosure required by those forms and to effect a closer integration of the disclosure requirements of the 1934 Act and the 1933 Act. Many of the revisions we have adopted, particularly those in Form 10-K, may require additional time and attention of those responsible for preparing them. In our judgment, the improvement in the quality of disclosure is worth the effort. In addition, improvement in the statements and reports filed under the 1934 Act is a necessary antecedent to revisions and simplification of 1933 Act registration, such as Form S-7 which I have previously discussed.

Since I have told you of the proposals which we have adopted, I should briefly refer to one proposal which we did not adopt -- the textual disclosure items of Form 10-Q. That form would have required disclosure of material events, such as those now required to be reported on Form 8-K, 45 days after the end of the quarter in which they occurred. This is less timely disclosure than is presently required by Form 8-K, the Commission's current reporting form, which is required to be filed 10 days after the end of the month in which the event occurs. The Commission believed to adopt such a requirement would be a step in the wrong direction. Accordingly, we have instructed our staff to consider a new current reporting form.

As you can see we have been active in considering and adopting new disclosure forms. However, these new forms can only be effective to the extent that companies comply with them. It is particularly important that the forms be filed when they are due, if investors are to have available timely information. In this regard, the Commission has instructed its staff to take whatever steps are necessary in order to reduce delinquencies in filings. Moreover, the staff's recent successful efforts to reduce the number of unreviewed 1933 Act registration statements will permit it to concentrate a greater part of its time in reviewing registration statements and reports filed pursuant to the 1934 Act. This should result in an improvement in the quality of disclosure in these forms.

In addition to discussing the importance of the formal periodic reports, required by the securities laws, I would also like to mention the need for other types of disclosure of corporate information. Whatever the requirements of formal periodic reports, as the Commission has emphasized in a recent release, there will never be a lessening of the need for companies to make disclosure to security holders and the investing public of important information concerning the company through releases, press conferences, letters to shareholders and other means. Companies should disclose promptly any material corporate development, favorable or unfavorable. The responsibility for making full and prompt announcement of material facts regarding a company's financial condition rests with the management of the company. Management is intimately aware of the factors which affect the operational trends of the business, and the company's security holders and the investing public in general need prompt dissemination of such information. Failure to make known important corporate information, whether it be good or bad, not only fails to serve the public needs but it may also violate the antifraud provisions of the Securities Exchange Act of 1934.

Dow Chemical Case.

Another matter of current interest to the Commission relates to the apparent growing concern over the social and general economic functions of corporations. We are watching developments in this area both in terms of what is appropriate by way of our disclosure and proxy requirements and also from the standpoint of how decisions in this area might affect our ability to provide informal and expeditious consideration of questions presented to us. Of particular interest is the Medical Committee for Human Rights v. SEC case decided by the United States Court of Appeals for the District of Columbia Circuit on July 8, 1970. In that case, the Court held that a determination by the Commission not to take enforcement action in connection with a proposal that a shareholder had submitted for inclusion in a proxy statement pursuant to the Commission's proxy rules is partially reviewable by the courts.

The Medical Committee had submitted a proposal to the Dow Chemical Company concerning that company's continued sale of napalm. In accordance with the Commission's proxy rules, Dow adivsed the Medical Committee and the Commission's staff that it did not intend to include the Medical Committee's proposal in the proxy statement since it did not believe it was required to do so. After the staff indicated that it concurred in Dow's legal analysis, the Commission, at the Medical Committee's request, considered whether enforcement action would be appropriate should Dow omit the proposal from its proxy materials. The Commission determined that it "would raise no objection" if the proposal were omitted; it did not state the reason for its decision or express any view on the merits of the staff's or Dow's legal interpretation.

Upon a peititon for review, the Court of Appeals rejected the Commission's contention that the Court lacked jurisdiction because no reviewable order had been entered. Instead, the Court concluded that since, in its view, the Medical Committee had been compelled to bring its controvery with Dow to the Commission and to exhaust whatever administrative remedies

were available and since an adverse decision by the Commission on the merits could be determinative should be Medical Committee subsequently seek to litigate its dispute with Dow in the District Court, the determination by the Commission was reviewable to the extent that it embodied a view of the legal merits of Dow's position. After offering extensive dicta on the meaning of the Commission's shareholder proposal rules, the Court remanded the matter to the Commission for an exposition of the rationale behind its determination to take no action in the circumstances.

The Court of Appeals subsequently denied the Commission's petition for rehearing, in which the Commission suggested that no procedures existed to be exhausted and that the kind of decision made was not of a character entitled to signifcant weight in a proceeding in a District Court.

The Solicitor General has until the 26th of November to file a petition for a writ of certiorari to the Supreme Court, should he determine that this would be the appropriate course of action to follow.

Even prior to the Dow decision, we anticipated an increase in the number of shareholder proposals relating to broad social and economic matters. Our staff is now considering procedures which will enable it to handle this anticipated increase with the limited manpower available. Despite the Court's finding of sufficient formality in our procedures to resemble an adjudicatory proceeding, we will attempt as best we can to preserve the informality of our procedures in order to accommodate the time schedules imposed on corporations soliciting proxies.

We are also considering methods to handle the appeals we anticipate will be made from our disposition of these matters. Since one group will always be dissatisfied with any determination we made, we anticipate a number of appeals. These appeals will inject more delay into the process of soliciting proxies.

Finally, although the Court did not render an opinion of the merits of the Medical Committee's proposal, it did, in some strong dicta, indicate how it believed our rules should be applied. For this and other reasons, our staff is reconsidering our substantive rules relating to shareholder proposals to determine if appropriate amendments are needed. Here again we would welcome well considered suggestions concerning means of improving our rules as they relate to shareholder proposals.