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An Overview of the Registration Statement Process

Thank you for having invited me to participate in this conference. It is always an opportunity to speak to such a body of professional interest in the matters that occupy my colleagues and me at the Commission.

To all our regret, Carlos Israels, who lent his great skill and contributed so significantly to this area of the law, is absent from the faculty today. It is surely not customary for a conference on securities law to be conducted by the PLI without him. I share with you the sadness and loss in his passing.

My assigned topic this morning is "An Overview of the Registration Statement Process." You know what an overview is--it's a massive oversight, like failing to see the forest for the trees. That's probably why I'm first on the program. I'm like the first year of law school and the cathartic confusion it creates. But nevermind, you will hear many learned things from the rest of the faculty that will pull it all together for you.

I guess I do have some cause to speak on registration statements. I was engaged in the process over the years as underwriter's counsel and as issuer's counsel, and for the last two years I've seen it at the Commission table. The view from there I found is not remarkably different. Certainly it was the least difficult adjustment I had to make between private practice and the SEC. I believe there is this essential coincidence of view, between the Commission and the securities bar, and I shall come back to that point a little later.

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The job of the prospectus and other disclosure documents is to communicate, to the investor. The ideal of the Securities Act is to create an environment where the investment decision can be a severely logical act based on stated and financially relevant facts. At least some investors value the guts disclosure in the prospectus. More should be brought to do so, and that can be done only by achieving greater readability. Disclosure becomes an exercise rather than a function when the information, even if it is all there, is so poorly organized and expressed that the prospectus does not communicate.

Communicating within the strictures of the 1933 Act, of course, is no mean task. It is a more creative undertaking than simply selling, or simply protecting. The challenge is to state all the material factors in a manner that informs, again that communicates. I guess I am suggesting there are nobler reasons that the lessons of Bar Chris for the profession to avoid cut and paste jobs.

To go to the law, there are cases other than Bar Chris that are relevant. Some courts have actually begun to impose liability for filings that contain all the required information but fail to communicate it in an understandable fashion. In Norte & Co. v. Huffines, for instance, affirmed this week by the Second Circuit, Judge Mansfield found a merger proxy statement misleading. For one thing it stated in a prominent place that there was no market for the stock of the acquired corporation, which was true, and then made disclosure of prior private purchases of that stock by the controlling persons of the acquiring corporation "buried as a tailend reference." The Court faulted it as not being "disclosed in a meaningful location." With respect to another disclosure, concerning the time lag effect in earnings of an insurance company that results from a reduction in sales, Judge Mansfield said:

> "Instead of flatly so stating, . . . the proxy statement engaged in a type of circumlocution that would require an extraordinarily persevering and persistent stockholder to figure out the actual fact. This was accomplished by the device of fragmentation, i.e., separately inserting piecemeal statements with respect to the matter in different locations in the

> statement. . .The trouble with such. . . (fragmented disclosures) is that while they might lead an extraordinarily able and inquiring stockholder to apply them to figures elsewhere in the proxy statement, the average stockholder reading the statement could not be expected to go through such a tortuous and difficult process." (emphasis added)

That's what the court said, but I don't want to talk law. I want to talk about professional attainment. Prospectuses filed with us do show a noticeable variation in the quality of craftsmanship. In those filings where counsel has obviously given a lot of thought to organization of the material and a lot of care to the writing, the prospectus stands out irrespective of the merits of the issue. I hope the younger lawyers among you who are newly coming to this registration process will bring to it a strong sense of professional pride in the product. That does not mean hiding in legalese.

Regardless of the degree of craftsmanship, there are at least two obstacles to developing clarity in the prospectus. One is the nagging ambiguity about the nature of the person to whom prospectus disclosure is directed. The other is the mounting complexity of the registrants' businesses, in this age of conglomeration--of the registrants' capital structure, in this age of the series convertible--and in the nature of the transaction itself, in this age of the exchange offer and takeovers.

The first obstacle, I said, is the problem of disclosure to whom. The naive, uninformed investor? The sophisticated, professional analyst? Or the illusive reasonable man? I thought Commissioner Wheat in the Disclosure Study framed it candidly:

> "Throughout its history, the Commission has struggled with these questions. They may well be unanswerable. A balance must be struck which reflects, to the extent possible, the needs of all who have a stake in the securities markets."

The problem of designing a prospectus for a relatively wide range of investor comprehension merges into the second problem, that of the inherent complexity of the particular enterprise or transaction. Some prospectuses or proxy statements almost defy understanding by even the experienced investor. This becomes critical in certain exchange offer or merger situations where the time is limited within which a decision must be made. In these cases you and we should not simply throw up our hands and fall comfortably back on language more appropriate in a trust indenture or an insurance contract. I hope we are both dedicated to the viability of a disclosure system that preserves and enhances the individual's freedom and ability to decide for himself. We must be sure we do communicate to him.

I want to point out two approaches the Commission has been taking to these vexing problems. First, in the case of a new speculative security, as you know, the Commission has for several years required an introductory statement that enumerates in a clear manner the special risks of the offering. In the last year we have been insisting on a relatively clean cover page that spotlights in italics with page number reference the special risks.

Second, in the longer merger proxy statements and exchange offer prospectuses, even where the enterprises are not speculative, we have for the last several months been requiring a separate summary of information to be set forth at the beginning of the document. This is still something short of the guide recommended in the Disclosure Study, but in the face of the number of prospectuses and merger proxy statements running in excess of 20 or 30 pages (including financials), movement in the direction of a prefatory summary is inevitable. I believe that the development of a summary at the beginning of relatively lengthy prospectuses is a more feasible approach than the use of separate summary prospectuses.

I would like to urge the Bar to experiment voluntarily with relatively short, concise and readable summaries at the beginning of lengthy prospectuses and proxy statements. The Division of Corporation Finance has assured me that filings containing such summaries will in no way delay the clearance process with the Division and they will make it a special point that this be so.

Indeed, they believe it will if anything, facilitate review for them. There is a natural inclination for cautious counsel not to innovate or depart from precedent. But the problem is serious enough that I think caution dictates doing something in that direction.

Summarizing complex matters in a prospectus undoubtedly is a difficult undertaking, but it is a necessary undertaking for those of us who value disclosure above some other form of regulation and above a practice that may now result in non-disclosure to many recipients of the document.

The Disclosure Study urges the Commission in effect to take a tougher position on Rule 460(f). That Rule, you will remember, provides that the Commission in passing on requests for acceleration is to consider whether there has been a bona fide effort to make the prospectus reasonably concise and readable. The Note to Rule 460 conditions the general policy to permit acceleration on, among other things, "the facility with which the nature of the securities being registered [and] their relationship to the capital structure of the issuer and the rights of holders thereof can be understood."

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Because I know time in registration is a matter of concern to you as it is to us, I would like now to make a few quantitative comments on the processing operation itself, and then steps which counsel can take in facilitating the examination of statements filed with the Commission.

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Four years ago, during the fiscal year ended June 30, 1965, about 1400 registration statements, including those covering investment companies, were filed with the Commission. Last year almost 3000 statements were filed. In fiscal 1969 the Commission received about 4700 '33 Act filings, representing an increase of over 60% above the 1968 filings and almost 300% over 1965. In marked contrast, the employment level in the Divisions of Corporation Finance and Corporation Regulation has changed hardly at all

in those four years. In 1965 those Divisions had approximately 370 employees whereas in 1969 the level had risen by only three people--to 373.

Although the number of '33 Act filings processed and disposed of has increased significantly, tripling from around 1300 in fiscal 1965 to 3800 in 1969, a severe backlog has developed. At the end of August, excluding investment companies, there were 379 registration statements and 161 post-effective amendments pending. Investment companies had 132 '33 Act registration statements and 57 post-effective amendments pending. And there are a significant number of first filings among them, which generally take more time to process by the Divisions than "repeat" filings. First filings are on the increase. For example, of the filings in fiscal 1965, only about 460 represented filings by new issuers. In 1968, about 900 were new issuers. In fiscal 1969, 2450 were first-time filings! That was more than one-half of all filings in that year. The large volume of filings and the large proportion of new filings have continued in July and August of this year, and exceed comparable figures for July and August 1968.

The result: the median processing time for 1933 Act statements had increased from the 36 days in fiscal 1965 to 65 days in 1969. I stress that these processing times are median figures. Certain issuers granted expedited treatment will have processing times below, them; others, of course, may experience much longer periods in registration.

Granting expedited treatment to certain well-prepared filings is one way the Commission has responded to the backlog problem. This device has been in effect since November 1968 (Release 4934). Unfortunately, it has not had a significant effect in shortening the lengthy median time in registration that has been so difficult both for the Commission and the securities industry. In fiscal 1968, with no expedited treatment policy, and fewer filings, the median processing time was 44 days. In fiscal 1969, with a 60% increase in filings over 1968, the time increased to 65 days, even though expedited treatment was being granted for over half that year to about a third of the issues.

If we had not adopted the expedited treatment approach, however, it is difficult to imagine what may have happened to the backlog volume. And for those issues receiving expedited treatment, of course, the effect is dramatic. In June and July of this year, a total of 586 registration statements processed by Corp Fin became effective. Of those, 251 or about 40% had received summary treatment, and for them the median number of days between filing and notification from the staff that there would be no comment or minor comment was 5 days for those made effective in June and 11 days for those in July. The median time between filing and comment letters on the statements that had been given regular treatment was 49 days for those made effective in June and 53 days for those in July. The difference between about 8 days and about 51 days, I assume, is real enough.

There are really four categories or gradations of review which the Division of Corporation Finance gives to '33 Act filings.

The first is where the staff decides upon initial review that the filing is so poorly prepared or involves such serious problems that spending further time on it is not warranted. This approach is commonly known as "bed-bugging" the registration statement. No comments are given on the statement, but counsel is notified as promptly as possible of the staff's position. Although the number of statements "bed-bugged" during each month so far during the calendar year has not been systematic, significantly fewer were "bed-bugged" in the four months period just past than in the first four months of this year.

The second review category is expedited treatment. Here the staff conducts only a cursory review of the filing and decides no further review or comment is required. Only a pricing amendment is filed, and, of course, time is saved on all sides. Letters from the issuer's chief executive officer, the auditors and managing underwriter are requested as supplemental information. These persons must represent they are aware only a cursory review has been made and of their statutory liabilities under the '33 Act.

A variation of expedited treatment may be termed "summary treatment." This is where only a cursory review is made, but limited comments are given either orally or by a short letter. The staff doesn't give these filings the amount of time alloted

to normal review, but does spend more time than in the expedited treatment situation. Since filings which merit this kind of treatment should not contain major disclosure problems, the comments do not usually present serious problems for counsel.

The fourth category is the regular review procedure. Here the statement is subjected to detailed, meticulous review. This approach takes large amounts of staff time, but is by far the treatment given most frequently. It is a rare first-time filing that receives expedited treatment.

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Having sat in your seat at one period in my life, I asked my legal assistant to canvas assistant directors and branch chiefs in the Division of Corporation Finance for specific suggestions, based on their bad experiences with filings over the last year, on what counsel can do to expedite processing. Here is what he reports to me. Some of it frankly surprises me.

There is some indication that the cross-reference sheet objectives of a careful review by counsel of the disclosure in the prospectus against the applicable items of the form are not always achieved. Such a review necessarily involves checking out instructions to the items. A too common deficiency is the omission of required consents of individuals about to become directors and consents of counsel rendering opinions on tax matters.

The guides in Release 4936 are apparently too often overlooked prior to the first filing. Since the staff routinely checks disclosure in the filing against the items in that release, counsel should seek to respond to all applicable items in the first filing. The covering letter or a memorandum accompanying the initial filing should include explanations as to where responses to certain items in Release 4936 may be found in the prospectus and, tersely, why responses to other items were not made.

Amazingly, one or the other of the boiler plate legends required--by Rules 425 (not SEC approved), 425A (dealer delivery), 426 (stabilizing) and 433 (red herring legend)--are sometimes missing.

If a repeat filing has been modeled after a recent effective filing of the same issuer, this should be indicated along with the registration statement number of the previous filing and an explanation of how the present filing differs from the previous one. If the changes are not substantial, redlining is most helpful.

The covering letter should indicate the proposed time schedule for the offering. The timing, of course, has to be realistic and take into account the Division's backlog I described earlier.

If counsel believes expedited treatment of the filing is justified, he should so indicate in his covering letter and explain his reasons to the staff. I point out, however, the decision to grant expedited treatment depends to a great extent upon the quality and meticulousness of counsel's preparation of the statement. You will save time in the long run by doing a good job on the initial filing, rather than sending down a poorly-prepared statement and correcting it by amendment.

Where an indenture is required for an offering, it would be helpful to point out the model used, whether it be the ABA or some other model, or the '39 Act itself. Review of indentures takes large amounts of our attorney's time and assistance in this area would be very helpful.

As I indicated earlier, where a speculative offering is involved, consideration should be given to the need for an introductory statement which summarizes the factors making the offering one of high risk. These should include, for example, disclosure of an absence of operating history, or an erratic operating history, lack of management experience, disclosure of deficits and heavy debt burdens, competitive disadvantages faced by a venture or product without an established reputation, heavy concentration of sales to one or a few customers, limited sources of raw materials, material litigation, and all aspects of promoters' and underwriters' compensation.

When amendments are filed, the covering letter or an accompanying memo should take each item of the staff's letter of comment and respond to it by pinpointing the revision in the registration statement or explaining why the comment was not complied with. At least four redlined copies of the amendment should accompany the filing to assist the staff in reviewing changes. Simply running a red-mark down the margin of an entire page, however, is not much assistance. The redlining should be specific so that changes will stand out.

Where applicable, counsel should indicate whether the underwriting compensation arrangement has been reviewed by the NASD, and the results of that review. If the offering has been changed, the amended filing should also be provided to the NASD for review. The staff should be notified this has been done and any reaction by the NASD communicated.

In view of the possible length of time between the initial filing and amendment, registrants must be prepared to update the information in the filing as required. This applies not only to financial statements, but also to such things as backlog figures, capsule sales information, status of material contracts, and market prices of the issuer's securities.

Be sure the request for acceleration is in order. Under Rule 461 the request must be made by the issuer, the managing underwriters and any selling security holders. The request should be received at least one full day prior to the date the Division is requested to grant effectiveness, or at least two full days prior to the date the Commission is requested to grant acceleration.

After the statement is filed, you are asked to do the impossible: avoid telephone calls to ascertain the status of the filing. Realistically, the staff can't really judge the length of time processing will take unless expedited treatment is granted or the statement is a repeat filing. These phone calls consume the time of the branch chief and other personnel assigned to the filing, and ultimately contribute to delaying all filings. On the other hand, if some material development occurs which affects the filing, a brief phone call may expedite rather than impede the processing procedure. This would be particularly true, for example,

after the letter of comment has gone out and the time schedule for amendment and proposed effectiveness becomes more definite.

When acceleration is requested, the managing underwriter should inform the staff of the distribution of preliminary prospectuses, pursuant to Release 4968. Apparently, that is sometimes overlooked.

As you can see, most of these suggestions call essentially for careful preparation, anticipation of disclosure problem areas, and adequate communication between counsel and the staff. Since they come from the people most directly involved in the processing operation and reflect lapses on the part of counsel they have seen, I trust you will use them to the mutual advantage of yourselves and the Commission.

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Well, my talk has become rather nuts and bolts. But they're important in this day when the effort is to keep a process operating at all. I have not left myself much time to talk about the dissemination of the prospectus to the prospective investor. It doesn't do much good, no matter how well prepared and processed it is, if the prospectus doesn't get sufficient circulation to inform the financial community and the public. We addressed ourselves, perhaps too abruptly, to that in Release 4968 in April. There we indicated that in implementing our acceleration power we would look for reasonable steps having been taken to furnish preliminary prospectuses, at least 48 hours prior to mailing confirmations, to those persons who may reasonably be expected to buy the securities. There were some ambiguities left with that release. I would have talked about it today, because I think its thrust is essentially correct, but the IBA on August 11th issued a memorandum to its members that I believe clarifies most of the points. Rather than my talking about it today, I suggest you read that if you haven't already seen it.

Neither have I left myself much time to talk about the future of the registration process. It seems clear to me that with respect to companies with securities already outstanding and being traded, Commission emphasis must shift from the now fulsome detail of 1933 Act offering prospectuses to improved 1934 Act periodic reporting. S-7 and the newly proposed revisions of Forms 10, 10-K

and 10-Q are steps in that direction. Ultimately, the handling and distribution of periodic reports will require, I believe, further applications of modern data processing, retrieval and dissemination technology.

Movement is also necessary toward making the tests of when registration is required more objective and less subjective. The newly proposed 160 series rules (Release 4997) move in that direction.

The world changes. I hope that each of you will feel you can play a constructive role in improving our disclosure system, so unique and admired in the world. We at the Commission welcome constructive critique and suggestions. Your expertise and experiences are invaluable to us. The Commission alone could not administer, let alone improve, the system. It depends heavily on the legal and accounting professions to make it work. Our interest is, as I am sure is yours, to make the system work well, the best it can, for all the public. In that I firmly believe there is an essential coincidence of viewpoint between us.

Thank you.