MEMORANDUM OF CONFERENCE

Between: New York Stock Exchange Representatives
and
Disclosure Study Group

Date: Tuesday, March 12, 1968

Present: From NYSE:
Phillip West, Vice President, Department of Stock List
Merle Wick, Vice President, Department of Stock List
Edward Zuhr, Assistant Director and Chief Listing Representative, Department of Stock List
James Buck, Executive Assistant, Civic and Government Affairs
Samuel Rosenberry, counsel, partner Milbank, Tweed
From Commission:
Commissioner Wheat, Richard Rowe, Charles Shreve, Ralph, Hocker, L. J. Millard, Bernie Garil, William Becker, David Ratner and the Study Group

Preliminaries

At the outset, by analogy to manuals provided with new British and American automobiles for the mechanic and the owner, Mr. Rosenberry pointed out the "two-market problem" with respect to information which we receive. In effect, he suggested that it is only useful to distribute to the investor that information which he can use and understand. More detailed information only should be for the professional market. We advised him that we are aware of this problem and are considering it but the solution is difficult.

I. Description of the Activities of the Department of Stock List

Mr. West described the activities of the Department of Stock List. There are 72 people in the Department and they cover approximately 1250 companies. In contrast, the London Stock Exchange has 14 people for 8000 companies. Listing representatives are divided on an industry basis and each representative covers approximately 100 to 120 companies. The listing representative attempts to keep knowledgeable on his particular industry and to obtain

comparable reporting by industry. It was pointed out that banks divide their lending officers on an industry basis.

The Department of Stock List performs continual educational functions with respect to listed companies giving particular attention to the need for timely disclosure of material events such as mergers, etc. The Department attempts to preserve the confidential nature of information and at the same time encourage timely disclosure when necessary.

In order to insure that timely disclosure is being made, the Exchange reviews unusual trading activity and price fluctuation in listed stocks. In the case of unusual activity companies are called and questioned. In addition, the Department has a clipping service which reviews a large number of newspapers each day and refers items relating to particular companies to the appropriate listing representatives by 9:30 a.m. each morning. When information is discovered by one of the foregoing means, the listing representative often calls the floor to halt trading until news is released.

In this regard Mr. West pointed out that there were 200 instances of the Exchange halting trading in a stock until an announcement of particular significance was made. He also pointed out that on occasion companies release information prior to notification to the Exchange and cited the Coca-Cola stock split and increase of dividend as an example. In that case, however, the market had apparently anticipated the information and the stock only moved 1/8th.

In summary, the Exchange puts more emphasis on the need for and insuring timely disclosure of material information than it does on filing of information. With respect to the education function, the Exchange often contacts companies and sends out releases on particular matters. For example, the Exchange sent out a release on publication of earnings per share and requested pro forma earnings for dilution problems be disclosed in news releases and obtained an agreement from Dow Jones to publish pro forma information. They have encountered a problem with newspapers publishing dilution effect on earnings per share, however, because the papers say there is no room to publish this information. For example, the Wall Street Journal rejects 30

to 40 stories per day. In this case the Exchange sometimes suggests to the papers that they don't publish anything.

With respect to compliance with filing requirements, the Exchange's functions are almost entirely educational and consist basically of talking with companies to encourage compliance. There was a discussion of Exchange delisting activities as a method to insure compliance. Last year the Exchange had a net loss of 12 companies and an additional ten companies in the first two months of this year. Most of the loss was caused by mergers and acquisitions. In 1966 there were 57 companies listed and 44 delisted. Of the 44, 30 were because of mergers and consolidations and 14 because of delisting criteria. The most prevalent delisting criterion was inadequate distribution of stock.

Commissioner Wheat asked about the use of the delisting procedure to upgrade business standards. He cited the example of Cresent Corporation and asked if the Exchange had considered delisting in this case. Mr. West pointed out the Exchange's problem of pointing to individuals. He stated that the Exchange wanted to delist Cresent, but City Investing was going to take over and this would have eliminated the problem. When that fell through a Canadian company was going to take control of Cresent but the Exchange discovered that the Canadian group was the same type of group that already controlled Cresent. He pointed out there is a new group now in the picture and the Exchange is hopeful that the takeover will be consummated and eliminate the problem. They pointed out that they had initiated an independent audit and were not taking action while the audit was being conducted. Commissioner Wheat suggested that the Exchange could have delisted Cresent on the basis of the Commission opinion. He stated that the Commission tries to cooperate with and help the Exchange and suggested that the Commission opinion should be sufficient for a delisting by the Exchange. He said that he understands the Exchange position, but believes such a position demands the taking of certain risks in spite of liabilities. He suggested that the Exchange has a tremendous opportunity to lead the way in enforcing disclosure and dissemination standards because it is in an excellent position to monitor disclosure and dissemination. He suggested that a promise by such a company to

improve its disclosure is usually not productive and suggested that an immediate delisting by the Exchange would have a long term beneficial effect for all companies. Mr. Rosenberry suggested that the Exchange must think of the shareholders of the particular company involved, but Commissioner Wheat stated that the Exchange must also think of the entire investment community. Mr. Rosenberry suggested that the stockholders often approve of allegedly improperly acting corporate officials and cited Fifth Avenue Coach as an example, but Commissioner Wheat said that this is often the case in fraud cases brought by the Commission and reemphasized the opportunity which the Exchange has to upgrade business and disclosure practices. He pointed out that the Commission may also encourage 34 Act compliance by relaxation of 33 Act requirements for those companies which do comply with the 34 Act.

II. Listing Application

Mr. Zuhr has 11 men on his staff to handle listing applications. There are two types of applications, i.e., original and supplemental, but there are no application forms. When a company wishes to apply for listing, it is given the stock exchange manual and an application of another company in the same industry. Usually there is a prefiling conference in which various problems of listing are discussed. The prefiling conferences assist in avoiding embarrassment for companies which do not meet listing requirements. Once an application is filed, it is published in the "Weekly Bulletin" which has a circulation of 7000.

Companies are allowed to incorporate by reference proxy statements and prospectuses, but not Form 10 registration statements. The main reason is printing expense for the Form 10 is only made in limited quantities and the Exchange requires approximately 750 copies of a listing application. In addition, the Form 10 is now practically obsolete with respect to listing applications because of Section 12(g) of the 34 Act.

Examination of a listing application is made by the listing representative and the accounting section of the Department of Stock List. Any significant problems are discussed with the Exchange's auditors or counsel. The company's latest prospectus, proxy statement and annual reports to shareholders for the last five years are subject to some review. Particular

attention is devoted to finding conflicts of interest. Occasionally, the Exchange uses an investigating agency to assist in its examination. Form 10-K's are used if particular questions are involved. There is not very much coordination with the SEC with respect to examination of listing applications. Inadequate or improper disclosure is not turned up very often although a few examples were cited such as Shick and Farnsworth. If examination discloses a conflict of interest between members of management and the company, such conflict is not always publicized because the Exchange attempts to eliminate such conflicts and publicity may exacerbate the problem.

Of the 750 copies of the listing application 580 are distributed to members of the Exchange, commission houses, news services, advisory services, government agencies, banks and law firms. The remainder are given to the Exchange mailing department and area available at no charge for anyone who wants them as long as the supply lasts. When the free supply is depleted copies are available for a small fee. Exchange members are asked for comments on new listing applications but such comments are rarely made.

The Exchange seeks new companies for listing. There are continually about 150 companies which meet Exchange requirements. Exchange personnel make contact with these companies in order to encourage them to apply for listing on the Exchange. Prior to the adoption of Section 12(g) of the 34 Act many companies did not want to list because of the disclosure of salaries and also Section 16 requirements. This is no longer a deterrent, however.

III. Annual Reports

A. Timeliness

Mr. Wick pointed out that approximately 2 percent of the listed companies have their annual report to shareholders out in 30 days, another 20 percent in 60 days and almost all in 90 days. The Exchange urges the release of preliminary figures prior to the release of the annual report to shareholders. Approximately 30 percent of the listed companies make a preliminary release in 30 days, another 50 percent in 60 days, and the remaining 20 percent before 90 days. The preliminary figures are not necessarily audited but are usually close to the final figures.

Such figures only include sales and net earnings. Occasionally, the figures are inconsistent with those published in the annual report to shareholders, and in one instance required a second annual report.

In 1966, 30 companies out of 1250 requested extensions of time for releasing annual reports to shareholders and ten of these involved printing problems. Most of these were out within 45 days after the 90-day period. Before granting an extension, the Exchange usually talks with the company's auditors and often contacts company officials. The Exchange will not grant an extension beyond the 90-day period if a company is going to treat an acquisition on a pooling of interests basis.

Mr. Wick suggested that the requirement for filing the Form 10-K should not be accelerated because it would cause a delay in the release of the annual report to shareholders. He stated that in order to prepare annual reports companies now can work with main accounting subdivisions without worrying about details. Then, after the annual report is prepared, companies prepare proxy soliciting material and later prepare schedules for the 10-K. In addition companies have tax returns to file at this time of year.

He further pointed out that the 10-K is needed by the professional and not the shareholder. He stated that the notes to the financial statements in the 10-K are more complicated than those in the annual report to shareholders and are usually prepared subsequent to preparation of notes to the financial statements in the annual report.

B. Substance

Various proposals with respect to annual reports to shareholders and 10-K's were discussed. Mr. Wick was in favor of a two-step 10-K with filing of the basic financials and notes at an earlier date and the schedules later, or as an alternative, including the annual report to shareholders as part of the 10-K with no Section is liability for the text. He suggested that the only valuable information in the 10-K not in the annual report to shareholders is that relating to unconsolidated subsidiaries. He said that time is not of the essence with respect to other items. He thinks that if the financial statements in the annual report to shareholders were made part of

the 10-K that the notes to such financial statements in the annual report would be "beefed up". He does not believe, however, that companies should be required to have identical financial statements and notes because some companies like to present the financial information in a different format than that called for by regulation S-X. He suggests that Rule 14a-3 under the 34 Act is adequate for any inconsistencies which may exist.

With respect to puffing or touting in the textual portion of annual reports to shareholders, the Exchange follows the policy of education and moral suasion to encourage companies to make meaningful and informative textual disclosure. There is some review of annual reports to shareholders by listing representatives and the Exchange accountants, and last year a group from the AICPA made some review. When particular touting is noticed, company representatives are contacted and encouraged to tone down such disclosure.

With respect to other substantive information which should be included in the 10-K, they suggested that a source and application of funds statement would be a significant improvement. The Exchange requests such a statement to be in annual reports to shareholders and presently over 1000 listed companies comply with the request. As to product line or divisional reporting for conglomerate companies, they suggested that the Exchange is working with the companies, the SEC and the accountants on a case-by-case basis and is waiting for something authoritative. As far as more detailed information is concerned, they suggested that many companies are now issuing shorter reports to shareholders with a supplement available upon request. They pointed out that, if information is required in a 10-K, companies tend to disclose less because they are worried about Section 18 liabilities.

They are not aware of any studies made to determine the most significant information to investors. They try to insure that people seek and obtain quality advice.

IV. Quarterly Reports

The Exchange requires companies to publish quarterly earnings before and after taxes and unusual or non-recurrent items. Approximately 99 percent of the companies publish such quarterly information and about 50 percent of the companies send quarterly reports to

shareholders. Eleven companies do not publish quarterly information and these include meatpackers, companies with business cycles longer than one year, seasonal and agricultural companies. They believe now that the meatpackers' old reasons for not publishing quarterly information are not valid as the companies now are diversified and also not as dependent on fresh meat.

Sales are not included because they may be misleading and companies historically have been reluctant to disclose sales. With respect to additional quarterly information, they suggest that we proceed slowly. Mr. West suggested the possibility of quarterly reports of sales, earnings and non-recurring items, and a summary, semi-annual income statement and balance sheet. They suggested that numbers be rounded off to three zeros to emphasize the fact that interim figures are estimates.

The Exchange conducts a follow-up procedure if quarterly figures are not published in 40 days. In the third quarter of last year they had to write or call about 40 or 50 companies out of 1250.

V. Current Reports

As to timely disclosure, there is no formal procedure for enforcement but the Exchange checks with companies from time to time. Mr. Rosenberry suggested that timeliness is a business decision and the Exchange shouldn't be in the area of making business decisions. With respect to what should be disclosed they pointed out that there are statements in the Exchange Company Manual and in the director's guide which give guidelines but are general in terms. The Exchange attempts to follow a continuing educational policy with companies as to what items should be disclosed.

There was a question as to whether the Exchange put out a letter with guidelines relating to predicitions. They stated that there was no formal letter but they have disseminated some information on an informal basis which is now set out in the Company Manual and in the corporate director's guide. Companies are advised to review predicitions when they change and to publish such changes as soon as possible. They do not make a follow-up examination,

however, on changed predicitions but, as stated earlier, they do make continual surveys of market activity.

They suggested that a Form 8-K must be an historical document and cannot be a substitute for the broad tape. They stated that they could not really suggest anything for most significant information is already disclosed currently in the news media. They recognize that an 8-K may be valuable for analysts and that is also encourages companies to reveal information on a timely basis. Mr. Wick said that they use the 8-K as a backstop for Exchange requirements.

With respect to particular items, options were discussed and there was a suggestion that the Exchange may eliminate the requirement for option disclosure in annual reports to shareholders because of our proxy requirements. They pointed out that the Company Manual is just a guideline for disclosure. The items listed therein must be disclosed but there is flexibility with regard to additions. These are often discussed with companies on a case-by-case basis.

VI. Dissemination of Information

The Exchange maintains a basic file on each company and also maintains a basic document file. The basic document file is microfilmed and kept in a microfilm jacket on a looseleaf basis. Additions are microfilmed and substituted in the jacket as appropriate so that there is a current basic document file on each company. In addition, microfiche was discussed and it was suggested that the proposed system would be a significant aid to the financial community.

VII. Critique of Securities Act Registration Requirements

A. Contents of Prospectuses

In general they suggested that people read what they can understand and that the annual report to shareholders is an understandable, widely-read document. Mr. Rosenberry suggested that the front page of the prospectus with the legal language is frightening and deters people from reading it. Estimates and projections were discussed and it was suggested that there would be great problems because of continual changes and the uncertainties involved. Mr. Phillips suggested that to eliminate some of the problems, the Commission could require companies to

explain results inconsistent with projections. They answered that "the medicine would be worse than the cure." With respect to merger proxies it was suggested that information on the acquiring company is unnecessary except to bring the business up to date and to describe the nature of the transaction.

B. Registration Requirements

Mr. Rosenberry suggested that the best test of value of the company's stock is the price on the Exchange and, accordingly, a company listed on the Exchange and traded for three years should be allowed to issue shares without registration provided there is some limitation as to the size of the offering. Commissioner Wheat asked whether we should relax disclosure requirements when there is no selling effort and Mr. West suggested that this is a good beginning. There was then a discussion as to whether relaxation of disclosure requirements should be related to selling compensation but such discussion was inconclusive.

C. Prospectus Delivery Requirements

Mr. Rosenberry suggested that pre-effective delivery should not be made because it would amount to selling a 48-hour put. It was suggested that this would not be the case if the prospectus did not contain the price. The matter was not discussed further. With respect to post-effective delivery, it was pointed out that the 90-day rule does not help the first buyer. There was no other discussion on this matter.