

CHAPTER IX

THE BREAKTHROUGH IN DISSEMINATION OF '34 ACT REPORTS

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CHAPTER IX

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A. Introduction

At the outset of its review of the disclosure requirements of the Federal securities laws, the Study recognized that it would be unwise to expand '34 Act reporting requirements without first improving existing means of dissemination of these reports. This chapter discusses the rapidly developing dissemination systems which should facilitate wider, more economical and more rapid distribution of those reports and greater use of the information they provide.

B. The microfiche system installed at the Commission in the fall of 1968 portends a major change in the dissemination of '34 Act reports and other disclosure documents.1. Development and current status of the Commission's microfiche system.

Methods for improving the dissemination of materials filed with the Commission have long been under consideration by the Commission's Office of Records and Services. Soon after its organization, the Study also participated actively in the development of an improved dissemination program. Various methods were considered. The "microfiche" was selected.

A microfiche is a small rectangular sheet of film on which many pages of typed or printed matter can be reproduced in a grid pattern. Most business and government installations which employ microfiche today utilize a film approximately four by six inches in size which can accommodate up to sixty standard-size pages of material. Such microfiche can be read by means of relatively inexpensive desk-top readers which project the microfiche image on a screen the size of a standard page. Somewhat more expensive reader-printer equipment is available which can produce a full-sized copy of any page of material being viewed on the screen.

In 1968, based on the joint recommendation of the Study and the Office of Records and Services, the Commission adopted a program under which anyone can obtain microfiche copies of various documents filed with it from a government contractor. The microfiche are of the standard sixty-page size. Individual copies of particular documents may be ordered or orders may be placed for various packages of documents on a subscription basis. At the outset, all of the basic K reports and all quarterly reports of investment companies filed on Form N-1Q were made available on microfiche. In response to the requests of actual and potential subscribers, the contractor has recently undertaken to offer, in addition, microfiche copies of registration statements

filed under the '34 Act on Form 10, annual and interim reports to shareholders, definitive proxy statements, effective registration statements under the '33 Act, and Form N-1R reports.

Microfiche are mailed to subscribers within five days after filing of the document, on a twice-weekly basis. Efforts are currently being made to reduce the time gap between the filing of a document and the mailing of microfiche copies.

The microfiche system supplements the hard copy reproduction service which the Commission previously offered to the public. This service enables anyone to obtain a copy of any public document filed with the Commission at a cost of 9¢ per standard page. The cost of a copy of a 60-page document is \$5.40. By contrast, a microfiche of the same document, individually ordered, would cost 75¢. On a subscription basis, depending upon the size of the subscription package, the cost per microfiche varies between 50¢ and 23¢.

In addition to these important direct economies, storage problems are virtually eliminated. A microfiche library requires a tiny fraction of the space needed to house the same volume of material in conventional form.

2. Other related developments in the uses of microfiche.

Since the announcement of the Commission's microfiche system, other programs have been developed which offer microfiche copies of documents useful in investment analysis.

One firm offers microfiche copies of all materials filed with the New York Stock Exchange, including all K reports, all listing applications, all quarterly reports sent to stockholders, any registration statements and proxy statements filed with the Commission, all reports on Forms 3 and 4, and annual reports to shareholders. A subscriber has the option of receiving these materials monthly, quarterly or annually and the subscription cost varies accordingly.

A second firm in offering, on microfiche, the corporation files in the securities research library assembled over the years by Merrill Lynch, Pierce, Fenner & Smith, Inc. Varying amounts of information on some 15,000 corporations are available in these files. Subscribers can select various subscription packages, including all companies, all New York Stock Exchange listed companies, all Amex listed companies, all over-the-counter companies, and selected over-the-counter companies.

3. Prospective developments in the dissemination of corporate information.

The high reduction of images possible under modern photographic technology permits the reproduction of up to 10,000 standard size pages on a four-by six inch microfiche. Automatic, random access readers capable of holding cartridges containing a number of such microfiche, and permitting the reader to locate

and display any one of many tens of thousands of pages, are on the market. Experiments have been conducted in the connection of such readers to a computer and their operation as computer peripheral devices. The addition of hard copy printout capability is technically feasible.

Whether machines such as the foregoing will be useful to the investment business in the foreseeable future is somewhat conjectural. They may be more readily suited to such applications as reference libraries specializing in medicine, engineering or law, where voluminous, relatively static materials are involved. Costs are high and are likely to remain so for some time. Nevertheless, microfiche technology is developing rapidly. It is entirely possible that less ambitious equipment employing individual microfiche containing up to 300 pages or so will be available and useful before long to the investment community.

Also of interest is the pace of development of computer-based financial information services. These services enable users of corporate information, particularly investment analysts, to tap vast quantities of data in a few minutes time, even though they may themselves be located at a point remote from the computer and its associated memory system. One such service now in operation permits access to historical financial information recorded on a computer tape for about 4000 companies. The presently available data includes

some 60 separate items of financial information covering a period of 20 years for each company. The information is up-dated as new figures become available. An eventual goal is the coverage of every publicly held company.

Although the full meaning of these developments cannot be foreseen at present, they lend significance to an effort to make information filed with the Commission available to all on as inexpensive and as timely a basis as possible.

C. Some implications of improvement in dissemination techniques and in the content and quality of '34 Act reports.

1. '34 Act reports are likely to be widely used.

The Study inquired not only into the question of how '34 Act reports could be made more useful, but also whether, if made more useful, they would be more widely used.

Many representatives of the securities industry with whom the Study conferred contributed to the Study's conclusion that improvement in '34 Act reports (the subject matter of the next chapter), combined with their prompt availability on microfiche, can be expected greatly to enhance their importance in the disclosure pattern.

An informal survey was conducted for the Study by a Committee of the Financial Analysts Federation, including one or

more representatives of such varied users of information as brokerage firms, banks, investment companies, insurance companies, investment advisory firms and foundations. These representatives indicated that at present their organizations made only meager use of '34 Act reports filed with the Commission. Eighty percent of this group, however, advised the Study that their organizations could be expected to subscribe for and make significant use of all or a major portion of the '34 Act reports filed with the Commission if such reports were both improved in content and available on microfiche at the prices outlined in the first section of this chapter.

2. The financial community should play a more significant role in communicating material information contained in '34 Act reports to investors.

Improved content and accessibility of '34 Act reports will, in the nature of things, tend to enhance the obligation of broker-dealers to make sure that material information in such reports is fully considered in recommending securities to investors.

Expanding upon this proposition, Milton H. Cohen, formerly Director of the Commission's Special Study of the Securities Markets, observed in 1966:

. . . for the most part the public's access to the disclosure files is and must be an indirect one, through the medium of the organized financial community of registered broker-dealers and investment advisers. This is as appropriate as it is

inevitable: while the disclosures are provided for the investing public and not the financial community as such, the latter is an essential middleman in seeking out, digesting, and evaluating data that would otherwise be far too voluminous to be of real use to most investors. Two types of obligations of this “middleman” community might well be established by regulations of the SEC or the self-regulatory bodies, the precise limits to be defined and refined from time to time in light of, among other things, improving techniques and changing economics of data dissemination: (1) obligations to consult the public file in connection with representatives or recommendations to customers regarding particular securities, and (2) obligations to communicate what is in the public file, in limited areas or on specified occasions of special importance.^{1/}

Mr. Cohen’s comments parallel a recommendation of the Special Study:

The importance of disclosure for the protection of investors has long been recognized in securities regulation, and it is of particular value in connection with selling practices. The present mandatory, officially filed disclosures by issuers (reports and proxy statements), extended and improved as recommended in chapter IX, should have wider and more prominent use in selling activities, and the obligations of broker-dealers in this regard should be appropriately defined by the self-regulatory agencies and the Commission. These obligations might include such matters as: actually consulting available officially filed data prior to recommending or selling specific securities; furnishing copies to customers in appropriate cases; and advising customers whether officially filed information is available with respect to any security recommended for purchase.^{2/}

^{1/} “Truth in Securities” Revisited, 79 Harv. L. Rev. 1340, 1377-78 (1966).

^{2/} Report of the Special Study of Securities Markets of the Securities and Exchange Commission, H.R. Doc. 95, 88th Cong., 1st Sess., pt. 1 at 329.

More recently, Professor Robert L. Knauss picked up the same thread:

I would think that the SEC could impose a rule which would . . . set forth what minimum investigation is needed in order for the broker-dealer to have an adequate basis for any recommendation he makes concerning a security. Specifically, I suggest the commission state that in the normal situation a broker-dealer should investigate the most recent material filed with the commission -- including the most recent Form 10K, and proxy statement -- and this be considered an adequate basis for a recommendation.^{3/}

The Study has given careful consideration to these suggestions. It is believed desirable for the Commission and the financial community to have the benefit of a brief period of experience with the new dissemination techniques, and with improved '34 Act reports, before specific rules are proposed. During that period, it would be also helpful to compare a representative sample of such reports with market letters and other literature distributed by the financial community regarding the reporting companies. Following this, the Commission and the self-regulatory organizations of the securities industry should give careful thought to steps which would insure that material information in reports filed with and made available by the Commission is adequately utilized by the brokerage community.

^{3/} Knauss, Disclosure Requirements -- Changing Concepts of Liability, 24 Bus. Law. 43, 52 (Nov. 1968).

Cf. Heller, "Integration" of the Dissemination of Information Under the Securities Act of 1933 and the Securities Exchange Act of 1934, 29 Law and Cont. Prob. 749, 765-66 (1964); Securities Act Release no. 4445 (February 2, 1962).

3. It should be possible to define in clear and reasonable fashion an obligation on the part of a broker-dealer to obtain and assess material information about a security and its issuer prior to submitting quotations for such security.

The obligation of a broker-dealer to consider available information concerning a security before submitting a quotation to an inter-dealer wholesale quotation service (generally the “Pink Sheets” prepared by the National Quotation Bureau, Inc.) is unsettled. Broker-dealers presently can trade by the numbers, i.e., submit bids or offers for securities based solely on the apparent market activity for a security, as indicated by the quotations of other dealers, with no knowledge as to the issuer or its business. Such a practice can play into the hands of the unscrupulous. The Special Study observed that --

Quotations even of nonexistent companies have on occasion slipped by . . .

* * * *

The quotations . . . do not indicate whether a company is in bankruptcy or furnish other highly pertinent data about it . . . many companies quoted have been liquidated, dissolved or merged without notation of this fact in the sheets.^{4/}

The National Quotation Bureau, Inc. is engaged in discussions with the staff of the Division of Trading and Markets as means of improving its standards relating to securities quoted in the “pink sheets.” It is not, however, equipped adequately to police the quotations submitted by broker-dealers.

^{4/} Id. Pt. 2 at 664; see also pt. 2 at 603-604.

The responsibility for obtaining and considering available information lies, in the first instance, with the broker-dealer submitting the quotation. It has been suggested that, as a minimum, a broker-dealer may have an obligation under the securities laws to consider the following categories of information before quoting a security: the identity and location of the issuer, the market for the security, financial information of the issuer, the market for the security, financial information concerning the issuer (preferably a recent balance sheet and profit and loss statement), the current nature of the issuer's operations, and whether or not the issuer files periodic reports with the Commission. It may be necessary for the Commission to give consideration to adoption of appropriate rules for this purpose.

Improved methods of dissemination of '34 Act reports should assist broker-dealers in meeting their obligations in this area.