Disclosure and "Corp Fin" Branch Chiefs
The SEC Review Process

KEYNOTE SPEECH

June 6, 1977

By Ray Garrett, Jr.

The promotional literature for this seminar includes at least one deficiency. It refers to the branch chief as an "operational ombudsman". If I understand the term correctly, an ombudsman is a government official whose job it is to help citizens who have problems with other government officials. Branch chiefs don't do that. Usually they create the problem.

Nevertheless the brochure is correct in describing the branch chief as the key figure in the operation of Corp Fin in its processing of registration statements under the 33 and 34 Acts. If Corp Fin were an army regiment, the branch chiefs would be company or battery commanders. The branch chief is in direct command of the division's regular day-to-day work. He is subject to policy guidance and review, including being overruled en specific matters from time to time by the Assistant Director to whom he reports, or occasionally by an Associate Director or the Director himself. He receives technical assistance along with hassles from the offices of the division’s chief counsel and chief accountant. But most problems do, and must, stop at the branch chief’s desk.

To many lawyers and officers of registrants, the branch chief for all practical purposes is the Commission. Not only is the branch chief directly responsible for much of the Commission's work, he is also responsible in large measure for the generally high reputation that the SEC has long enjoyed as compared with other government agencies.

What do we look for in a branch chief? Generally all of the good things: intelligence, honesty, integrity, industry and reliability, practical good judgment, and respect for the views and problems of others. Of course no one respects a pushover. Lawyers and registrants expect branch chiefs to be true to their charge of investor protection and the public interest. But along with the general virtues recited, the outstanding quality of the typical good branch chief over the years -- which so sharply distinguishes him from so many other government officials with whom one has to deal -- is a practical approach to getting business done. This includes an understanding of the registrant's problems, the importance of meeting reasonable schedules and deadlines, and practical honor in making and keeping agreements. Everyone knows that a government official cannot estop

the government in a formal sense. But in the processing of registration statements some respect for stare decisis and law of the case is decent and proper. Perhaps most of all, it includes a willingness to make decisions promptly so that transactions can move ahead.

In the care and feeding of the branch chief by the registrant and its lawyer, nothing tricky or fancy is required. What the branch chief wants is confidence in the lawyer to be honest with him and to do his homework, to be willing to make the tough decisions without leaning unduly on the branch chief, and to live up to his agreements and undertakings. The branch chief and his staff cannot exercise due diligence of the sort required of the registrant. The branch chief must be able to assume that he is being told the truth and that registrants will do what they or their lawyers say that they will do. If this assumption is for any reason brought into question, the nature of the relationship changes abruptly and the registrant may soon find himself dealing with another division. The branch chief is willing to work hard to meet schedules and deadlines, but only as he is convinced that they are not unnecessarily tight.

This businesslike approach of the typical branch chief goes back to the very beginning of the administration of the Securities Act. For those of you who have not heard the story, let me remind you that for the first year the Securities Act was administered by the Federal Trade Commission, which established a registration division for the purpose. The first director of that division was Baldwin B. Bane, who later with his staff moved over to found the registration division of the SEC, as Corp Fin was originally called. Baldy had been much involved in the legislative process leading to the enactment of the Securities Act and was very sensitive to the industry complaints that the Act would in effect cause the process of capital formation through the public distribution of securities to become virtually impossible. This would be so in part because of the fearful liability imposed by the Act but also because the bureaucrats would get the whole business fouled up. Baldy was determined to prove that the latter of these predictions would not occur.

After developing and publishing the registration form which was the predecessor of our present S-1, on the day set for the first filings, Baldy had organized his staff into crews to be ready to examine the first registration statements. When they came in on opening day, they were parceled out among these crews with instructions to report to Baldy in a week with the results of their examination. For 24 registration statements filed, a week later the staff came in with 24 draft stop orders. Every one had deficiencies in the judgment of the staff, and if one reads the statute and takes it literally, a stop order is the prescribed method for the Commission to challenge deficient statements.

It was equally obvious to Baldy that public financing would indeed grind to a halt if every registration statement got bogged down in a stop order proceeding. He therefore came up with the startling suggestion that the registrants be informed of the staff comments and be given an opportunity to cure the asserted deficiencies by amendment. This shocking thought prevailed at the FTC, and thus was born the deficiency letter, or "letter of comment", as the staff has always preferred to describe it. There also began the practice of the delaying amendment to prevent effectiveness from the running of the 20 days before problems with the staff could be resolved, to be followed, of course, with acceleration when deficiencies had been cured or resolved and the price amendment was filed.

It was regarded as very important that financings not be delayed because of administrative inefficiency; that if a registration statement was well prepared, the registrant could expect the letter of comment within 10 days from the filing day -- it was known until the early 1960s as the "10 day letter" -- and the registrant then had a fair shot at becoming effective on the 20th day after the filing. To achieve this objective -- which was achieved regularly until the whole system was swamped by the sudden increase in registrations that began to appear in 1958 and the years immediately following -- it was necessary for the branch chief and his assistants to begin examination of filings immediately, to work overtime if necessary, and to face up to questions and make practical decisions promptly. This approach is, as I have said, the distinctive feature of Corp Fin administration.

Also in those days, it is worth remembering, an acceleration order had to be entered by the Commission itself, which caused the Commissioners to develop work habits, including daily meetings, which continue to set that group apart from so many government bodies. It also caused the Commissioners to become very familiar with the underwriting and distribution processes and to be conscious of the central role played by the disclosures administered by Corp Fin in the total regulatory process. I cannot quarrel with the practical necessity of the delegation of the acceleration authority to the staff, once it became lawful for the Commission to do so, but it has had the effect of separating the Commission from daily contact with this portion of the work.

Recent trends and changes in popular philosophy raise some basic questions about this process and whether it should be continued. The good things about it seem quite clear to me. It gives the registrant practical protection against being surprised with a stop order. Everyone knows that staff review is not necessarily protection against Section 11 liability, but it is protection against being blind-sided by the Commission at the critical moment of offering. It is far more expeditious and economical for taxpayers as well as registrants to avoid formal proceedings as often as possible. I am sure that the process improves the quality of disclosures. And it generates a cooperative spirit between registrants and the

professional advisers and the staff which makes the whole process run more smoothly.

What could be bad about something that seems so good? Registrants and lawyers have argued from time to time that the practical necessity to obtain an order of acceleration gives the staff too much power, a "rubber hose" that can be used in derogation of the registrant's rights to defend its position. If this view should ever prevail, it could be cured without otherwise abandoning the review process. Other objections raise the question of whether companies deserve all of this attention at the taxpayer's expense, and also whether the process is too cooperative and not sufficiently adversary. The Commission in recent years has flirted with these ideas, most notably in the legislation it proposed regarding municipal bond disclosures. No doubt there were political considerations for the proposal to give up the filing and review function and to propose only that the SEC prescribe the standards of disclosure. If this had been enacted, or the same philosophy adopted for corporate filings, we would in effect move back to square one. Compliance with disclosure requirements would be achieved by litigation, either administratively through stop orders or injunctive or by private litigants.

It is popular today to talk about de-regulation, but most proposals that I have seen in this direction in other fields always seem to be combined with proposals for more litigation or at least they would have that practical effect. All things considered, perhaps a better case could be made for de-litigation than for de-regulation. Whatever failings Commissioners and the staff might have in handling overall disclosure policy, among other things, it seems unlikely that judges would do a better job, quite apart from the great expense and the unfortunate change in atmosphere that litigation brings.

Accepting the present law and procedures, the Commission is nevertheless faced with recurrent questions requiring that it decide how to proceed with the development of the law applicable to ever-changing circumstance. It continues to have a rather open choice to exert initiatives through adjudication or rule-making. In the last decade the Commission has employed the rule-making approach with great effectiveness if not with 100 percent success. It has done this through a variety of measures such as formal rule-making in the 140 series and significant changes in the various forms and .procedures, the publication of no-action and interpretive letters, and the several formal guidelines. Nevertheless, there may be a present imbalance toward the use of adjudication as the weapon of choice. While the Commission itself must struggle with these questions, it must apparently also look forward to examination under President Carter's reorganization program.

In considering the various detailed items presented by the materials in this seminar, it would be well to keep in mind that it is all part of a unique and I think

glorious process that has worked well for over 40 years but has to be rediscovered by each generation. In the years to come, we may all be engaged in the need to explain and justify once again this triumph of administrative ingenuity and determination.