

**REPORT OF THE TASK FORCE  
ON  
DISCLOSURE SIMPLIFICATION**

**United States Securities and Exchange Commission**

**March 1996**

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549  
OFFICE OF THE CHAIRMAN

March 5, 1996

Capital is the lifeblood of our economy. By guarding the integrity of our capital markets through full and fair disclosure, the federal securities laws protect investors while at the same time ease the ability for companies to raise funds from the public.

These laws, however, are not administered without cost. We who regulate our nation's financial markets must continuously strive to strike a balance between the benefits and the burdens posed by the rules we promulgate. For this reason, the SEC periodically reviews areas of its regulatory structure to see how they might be made more efficient and less burdensome.

In 1995, we undertook two such reviews. The Advisory Committee on Capital Formation and Regulatory Processes, ably chaired by Commissioner Steve Wallman, is concluding its work at this writing. The Committee is examining ways to improve the process for registering securities that are offered in our public markets, including the concept of registering companies as opposed to transactions or offerings of securities.

The second review, and the subject of this Report, was that undertaken by the Task Force on Disclosure Simplification. The Task Force was asked to review rules and forms affecting capital formation, with a view toward streamlining, simplifying, and modernizing the overall regulatory scheme without compromising or diminishing important investor protections. To balance our internal perspective

on these matters, I asked Philip Howard, an outspoken advocate of regulatory common sense, to lend a hand.

In a seven-month period, the Task Force reviewed most forms and rules relating to capital raising transactions; periodic reporting pursuant to the Exchange Act; proxy solicitations; as well as tender offers and beneficial ownership reports under the Williams Act. Suggestions were sought from interested organizations and hundreds of recommendations were considered.

The resulting report offers a regulatory blueprint for corporation finance in the years ahead. Together with the Commission's continued emphasis on the primacy of investor protection, these common-sense recommendations will help ensure that ours remain the strongest, most vibrant, transparent, and liquid capital market in the world for many years to come.

Arthur Levitt

HOWARD, DARBY & LEVIN  
NEW YORK, NY

March 5, 1996

The Honorable Arthur Levitt  
Chairman  
Securities and Exchange Commission  
450 Fifth Street, NW  
Washington D.C. 20549

Dear Chairman Levitt:

Simplifying securities regulation offers unusual challenges because the SEC acts, not just as the regulator of the markets, but as referee. Market participants are keenly aware of the need for the SEC to maintain a level and orderly playing field, and, in making these recommendations, the Task Force was mindful not to tip the balance among the many market interests.

Like all agencies, however, the SEC has suffered from the bureaucratic tendency to create ever thicker rule books. Each complication breeds another level of complexity and, over time, the original regulatory goal becomes obscured amid thousands of words of detailed dictates. Some SEC rules, intended to guide market participants in daily decisions, have become a kind of Latin liturgy,

comprehensible only to those of us who have devoted our professional lives to abstract regulatory nuances.

The Task Force began the process of simplification by combing the rule books for duplication and obsolescence. The resulting recommendations would clean out significant regulatory clutter. The Task Force then tackled several well-known regulatory problems, and has recommended overhaul of, for example, the format for prospectuses and the regulations governing trading during a distribution, as well as liberalizing rules for capital-raising by smaller companies.

The Task Force has sought to present an agenda for simplification that is sensible and achievable in a short period. This effort, however, is only the beginning. Changing long-established conventions is never easy; our eyesight has difficulty focusing on changes that in future years may seem natural and obvious. To help focus future reforms, the Task Force has identified anomalies caused by a misfit between statutory precepts born over 60 years ago and the realities of modern global electronic markets. Overall, the Task Force has sought to set out in a new direction, on a path where a regulatory agency sees its job always to monitor its own performance at the same time that it regulates ours.

The few months that the Task Force worked on this project demonstrated how ready all participants are for a fresh look. The SEC staff members who constituted the Task Force took on the challenge of simplification with enthusiasm and creativity. I could not commend them more highly. Many experts and practitioners offered ideas and comments revealing wisdom born of decades of practical experience. I thank my colleagues at Howard, Darby & Levin, particularly Gus Caywood and Ed Reitler, who were resourceful and helpful to me throughout the project.

Finally, I thank you for initiating the kind of self-examination that I believe is critical to the effectiveness of this and every government agency.

Yours respectfully,

Philip K. Howard

### **Acknowledgements**

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## I. ELIMINATION OF RULES AND FORMS

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Eliminate Regulation B (Rules 300-346), and accompanying Schedules A, B, C, and D, and Forms 1-G and 3-G, which provide a limited exemption for certain interests in oil or gas rights, due to its limited use and the availability of more beneficial exemptions

Eliminate Regulation E (Rules 601-610) and accompanying Forms 1-E and 2-E, which relate to a limited exemption for certain types of investment companies designed to aid small businesses, or incorporate Regulation E within Regulation A

Eliminate Regulation F (Rules 651-656) and accompanying Form 1-F, pertaining to a limited exemption for assessments levied on assessable stock and for resales of forfeited assessable stock, because the adoption of Rule 504 has significantly reduced the Regulation's utility

### OTHER SECURITIES ACT RULES

Eliminate Securities Act Rule 148, which sets forth a safe harbor for resales made under the repealed Bankruptcy Act, because the rule has become outdated

Combine Rules 152a and 236, both of which relate to fractional shares, and adjust the dollar cap under Rule 236 to account for inflation

Eliminate Securities Act Rules 445, 446, and 447, which relate to securities offered through competitive bidding, because these rules have become obsolete

Eliminate Rule 494, which relates to newspaper prospectuses of foreign government securities, because the rule has become outdated

### EXCHANGE ACT RULES

Eliminate paragraph (c) of Exchange Act Rule 16b-1, which pertains to the acquisition of securities resulting from a railroad or other carrier reorganization approved by the Interstate Commerce Commission

Eliminate Exchange Act Rule 16b-4, which pertains to certain holding company redemption transactions, because the rule is of marginal utility

## FORMS

Consider eliminating the Form D filing requirement under Regulation D and Section 4(6) of the Securities Act because the requirement has outlived its usefulness

Eliminate Form SR and, instead, require the use of proceeds following initial public offerings to be reported on Exchange Act reports

Eliminate Exchange Act Form 8-B, regarding registration of securities of successor issuers, because Exchange Act Rule 12g-3 has rendered the form largely superfluous

Eliminate Form 10-C and Rules 13a-17 and 15d-17, which require issuers registered under the Exchange Act and quoted in Nasdaq to report certain corporate events to the Commission and the NASD

Eliminate the exhibit requirements of Form 11-K that provide little information that is not otherwise available to plan participants

Eliminate Items 3(e) and 4(a) of Form F-6, governing the registration of American Depositary Receipts, because the elicited information appears to be rarely used

## II. PRESENTATION OF INFORMATION

### CLEAR AND ACCURATE DISCLOSURE

Develop a "plain English" introduction to the prospectus to enhance its readability by individual investors, by eliminating boilerplate "legalese" and requiring a summary of key information

Require a "plain English" summary sheet in tender offer statements, which would function as a "road map" by providing shareholders with answers to commonly asked questions about the offer

Allow registrants to include earnings releases, which often are written in "plain English," in their quarterly reports, thereby making such reports more readable and easier to prepare

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## SHELF OFFERINGS

### Smaller Issuers

Allow smaller companies to price the securities on a delayed basis in order to time securities offerings more effectively with opportunities in the marketplace

### Seasoned Issuers

Reconsider restrictions on "at-the-market" shelf offerings registered by seasoned issuers on Forms S-3/F-3

Permit companies engaging in shelf offerings to include secondary offerings without identifying the selling security holders until the time of the actual offering

Adopt a "universal registrant" rule, which would enable a parent company to name itself and its majority-owned subsidiaries as possible issuers on a shelf registration statement, and defer the choice of actual issuer until the time of takedown

Permit a company to reallocate securities, or register a new class of securities, on a shelf registration statement by post-effective amendment

Permit seasoned issuers to register a dollar amount without specifying the classes of securities being registered

Allow seasoned issuers to pay registration fees at the time securities are taken down from the shelf

## FUNDAMENTAL CHANGES .

Consider clarifying what is a "fundamental change" to provide registrants with certainty regarding when a post-effective amendment is required

## BROKER-DEALER RESEARCH REPORTS

Consider streamlining and modernizing the safe harbors provided in Securities Act Rules 137, 138 and 139 relating to the use of broker-dealer research reports

## MARKET-MAKING TRANSACTIONS

Eliminate an affiliated broker-dealer's prospectus delivery obligation in connection with "regular way" market making transactions

## AFFILIATE STATUS

Consider revising Rule 144's definition of "affiliate," consistent with Section 2(11) of the Securities Act, to exclude certain persons, such as some outside directors, who are not actually or potentially in a position to control a company's offering activities

## TRUST INDENTURE ACT OF 1939

Permit a shelf registrant to qualify an indenture by post-effective amendment so that it need not file a new registration statement when adding a new class of debt securities

Eliminate Forms T-1 and T-2 for determining trustee eligibility and, instead, require an issuer to make an "eligible trustee" representation in the registration statement

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Liberalize the local offering exemption by adding a "substantial compliance" provision, expanding the concept of residence for individual and business purchasers, relaxing the triple 80 percent "doing business" test, and shortening the resale exemption for certain local offerings that cross state lines

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Expand the Regulation A exemption by permitting small businesses to raise five million dollars within six months rather than five million dollars per year

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Reduce the regulatory burden on nonreporting companies engaged in exempt offerings under Regulation D by permitting the use of uncertified financial statements when the offering amount is five million dollars or less

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Move substantive disclosure requirements out of rules and into schedules

Reduce the disclosure obligations for an investor with a passive investment purpose, who acquires or holds more than five percent but less than a certain percentage of a company's equity securities, by allowing such an investor to file a short form Schedule 13G rather than a Schedule 13D report

Permit investors with passive investment intent to use Schedule 13G

Codify staff position permitting control persons of institutional investors to file jointly with such institutional investors on Schedule 13G under certain conditions

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Consider permitting direct mailing of proxy soliciting materials to non-objecting beneficial owners of voting securities held of record by brokers, banks and other intermediaries

Consider eliminating filing of preliminary proxy statements in contested elections of directors

Study the shareholder proposal process

## EXCHANGE OFFERS

Place certain seasoned issuer exchange tender offers on the same footing as cash tender offers by permitting such issuers' registration statements to go effective automatically upon filing

In registration statements relating to exchange offers or other acquisitions involving nonreporting target companies, require only financial information about the target company that the target company has provided to its shareholders

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Exempt certain internal holding company reorganizations from registration so long as the reorganization is the sole purpose of the transaction and fundamental shareholder rights and interests remain substantially unchanged

Ease financial disclosure requirements for internal holding company reorganizations that are subject to registration

### SPIN-OFFS

Codify a rule permitting certain unregistered spin-offs of subsidiaries or divisions by reporting companies

### EXCHANGE OFFERINGS

Broaden the circumstances in which the guaranteed convertible securities of a wholly owned subsidiary can be exchanged for those of its parent without the expense and delay of registration

Codify staff positions permitting certain unregistered issuances of securities pursuant to Securities Act Section 3(a)(10) that have been subject to judicial or administrative review and approval

### AMERICAN DEPOSITARY RECEIPTS

Eliminate the requirement to register under Section 12(b) of the Exchange Act American Depositary Receipts registered on Securities Act Form F-6

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Expand the circumstances in which companies may terminate registration under Section 12 of the Exchange Act

Similarly revise the rules governing when companies may suspend Section 15(d) reporting obligations

Promulgate a rule pursuant to Section 12(h) of the Exchange Act permitting the modification of periodic reporting obligations for certain companies in bankruptcy or liquidation

Re-examine periodic reporting obligations under Section 15(d) of the Exchange Act to ensure that such obligations are more closely aligned with the period during which securities are actually sold

#### CONCURRENT EXCHANGE ACT/SECURITIES ACT REGISTRATION

Permit a company to register concurrently a public offering under the Securities Act and a class of securities under the Exchange Act by filing a single form that would cover both registrations

#### SECURITIES ACT FORM ELIGIBILITY

Permit a company to switch to a shorter Securities Act form at the time of filing any amendment if it has become eligible to use the shorter form since filing its initial registration statement

Exclude automatically effective registration statements on Form S-8 from the general rule that filings are deemed to be on the proper form unless objection is raised by the Commission prior to effectiveness

### IX. DISCLOSURE GENERALLY

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Eliminate the \$100,000 "one size fits all" materiality standard for certain environmental legal proceedings and replace it with a general materiality standard to ensure that companies will not be required to disclose non-material information

#### EXECUTIVE COMPENSATION

Consider clarifying and streamlining the rules governing when companies must disclose executive compensation information in registration and proxy statements

#### OTHER REGULATION S-K MODIFICATIONS

Streamline Item 101's disclosure requirements relating to the description of the registrant's business by eliminating duplication of quantitative information provided in the financial statements

Revise Item 102 relating to the description of property to elicit more meaningful and material disclosure

Limit the scope of Item 507, relating to securities offered for the account of a company's individual security holders, so that a company only would have to disclose information regarding certain of its selling affiliates and significant beneficial owners rather than all of its selling security holders

Move undertakings in Item 512 into a rule in Regulation C, and clarify when offers and sales may be made when a registrant has an obligation to file a Section 10(a)(3) updating prospectus

Eliminate Item 702's requirement to state the general effect of any arrangement regarding indemnification of a registrant's directors, officers, or control persons, which typically results in "boilerplate" disclosure of minimal value to investors

Adjust certain dollar thresholds in Regulations S-K and S-X for inflation since the time of their adoption

## EXHIBITS

Create a new exhibit form, which would enable a company to file most of its exhibits on one form, thereby making such exhibits easier to locate and update

Permit automatic effectiveness of a post-effective amendment filed solely to add an exhibit

Eliminate specific exhibits that appear to be rarely used or contain information that is otherwise available

## INDUSTRY SPECIFIC DISCLOSURE

Modernize the existing Industry Guides, consider adopting additional industry-specific disclosure rules, and relocate all such guides and rules within Regulation S-K

## STAFF LEGAL BULLETINS

Consider publishing "Staff Legal Bulletins" to announce significant legal interpretations of interest to a wide group of issuers

## EDGAR

As part of the study regarding the EDGAR filing system, consider whether certain EDGAR forms should be eliminated at some future date

Enable EDGAR filers to receive certain filing date adjustments without the need for a case-by-case determination by the staff as to whether the request should be granted

Pursue an electronic linkage of EDGAR with the exchanges, Nasdaq and NASAA

## X. TRADING PRACTICES RULES

### DISCUSSION OF THE TRADING PRACTICES RULES

#### RECOMMENDATIONS

Replace the trading practices rules, which have become unnecessarily complicated and burdensome, with a new, streamlined, more understandable regulation that would restrict a narrower range of activities, persons and issuers

## XI. ACCOUNTING DISCLOSURE CHANGES

Permit companies to "income average" when determining the significance of acquisitions and equity method investments, thereby refining the circumstances when the company must provide separate financial statements to those instances where the acquisition or investment is truly significant

Reduce the effect of the 45-day "black out" period during which many registrants are effectively prevented from undertaking a public offering by narrowing the scope of the accounting rules requiring updated audited financial statements in certain registration statements declared effective 45 days after the registrant's fiscal year end

Expand the circumstances in which a company may incorporate by reference audited financial statements of significant investees so that such statements need not be reproduced in filings with the Commission

Streamline the complex and often confusing rules requiring separate audited financial statements of affiliates whose stock collateralizes a registrant's securities, and of persons who guarantee a registrant's securities

### ELIMINATION OF ACCOUNTING RULES

Streamline accounting and related disclosure requirements by eliminating duplicative rules and those rules that have outlived their usefulness

## XII. TECHNICAL CHANGES

Make technical changes to numerous other rules and forms, which in the aggregate should render the Commission's disclosure requirements easier to understand and follow

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## **SUMMARY OF SIGNIFICANT RECOMMENDATIONS**

Chairman Arthur Levitt organized the Task Force on Disclosure Simplification in August 1995 to review forms and rules relating to capital-raising transactions, periodic reporting pursuant to the Exchange Act, proxy solicitations, and tender

offers and beneficial ownership reports under the Williams Act. The goal was to simplify the disclosure process and, consistent with investor protection, to make regulation of capital formation more efficient.

To aid its review, the Task Force met over a seven-month period with issuing companies, investor groups, underwriters, accounting firms, lawyers and others who participate daily in the capital markets. These participants helped the Task Force to identify and formulate reforms that reduce costs and regulatory burdens without impairing the transparency and integrity of our capital markets. None suggested wholesale deregulation, and virtually all emphasized the importance of basic regulatory goals to preserve orderly markets.

The recommendations that follow would eliminate or modify many rules and forms, and simplify several key aspects of securities offerings. Certain recommendations reinforce the Commission's other initiatives to improve the disclosure process, and should be viewed as part of those ongoing efforts. The recommendations roughly fall into three categories:

- (1) Weeding out forms and regulations that are duplicative of other requirements or have outlived their usefulness;
- (2) Requiring more readable and informative disclosure documents; and
- (3) Reducing the cost of securities offerings and increasing access of smaller companies to the securities markets.

In addition to specific recommendations, the Task Force has sought to identify anomalies of the regulatory structure. The basic structure has served the markets well for over 60 years, but should be rethought in the age of novel financial instruments and virtually instantaneous electronic communication and clearance settlement practices. Re-configuring these regulatory tenets must be done with caution, in order to avoid tipping the balance in favor of certain market participants or jeopardizing investor protection. But the need for modernization is apparent, and the Task Force has identified areas for Commission review. Of course, in considering how the Commission would like to proceed with reviewing any of the matters discussed in the Report, the Commission should thoroughly consider the scope of its authority and other related issues.

A summary of the principal recommendations follows.

### *I. Elimination and Streamlining of Rules and Forms*

The Task Force recommends eliminating or modernizing many rules relating to disclosure and registration procedures to simplify the rule books and reduce the

cumulative burden of compliance. By eliminating unnecessary detail, these recommendations also should help focus disclosure on issues of importance to investors. If all of the recommendations are implemented, the Commission would eliminate 81 rules and 22 forms, and modify dozens of others. In total, the recommendations would eliminate or modify approximately 23 percent of the rules and 54 percent of the forms and schedules reviewed by the Task Force.

Selected examples of the recommendations are as follows.

#### Streamline Accounting Disclosures

Many accounting rules have become outdated or duplicative of the requirements of "generally accepted accounting principles," resulting in unnecessary complication and expense. Upon review, the Task Force recommends eliminating 11 accounting rules and 9 staff accounting bulletins. The Task Force also recommends modifying other accounting rules that appear to be unnecessarily restrictive.

For example, some companies awaiting audit of their year-end financial statements have a "black-out" period in which they cannot issue new securities. The Task Force believes this period is unduly restrictive in light of other ongoing disclosure obligations, and recommends retaining the requirement only for initial public offerings. These and other accounting-related recommendations are discussed more fully under "Accounting Disclosure Changes."

#### Eliminate Outdated Regulation

Many rules, while well conceived when initially adopted, have become obsolete. For example, Regulation B, adopted in 1963 (and substantially revised in 1972), provides an exemption for certain offerings of "fractional undivided interests" in oil and gas rights. Despite its eight pages in the Code of Federal Regulations, the Regulation has fallen largely into disuse as a result of changes in the energy market and the availability of other exemptions. Another set of obsolete rules was promulgated in the late 1940s to govern securities offerings through competitive bidding with multiple underwriters. The rules were adopted largely to accommodate other rules which have themselves already been discarded. As explained more fully under "Elimination of Rules and Forms," the Task Force recommends that these and similarly outdated rules be eliminated.

Disclosures required of issuers include numerous outdated or ostensibly immaterial categories. The Task Force recommends modifying dozens of requirements in virtually every area of corporate finance, from raising dollar thresholds for disclosure in Regulations S-K and S-X to updating industry-specific disclosure requirements in the Industry Guides.

Another outdated standard is the requirement that companies disclose government environmental proceedings that may result in monetary sanctions of \$100,000 or more. Depending largely on the size of the company, this requirement can result in disclosure that is not material to a particular company. Therefore, the Task Force proposes that the Commission replace the \$100,000 "one size fits all" standard with a more flexible general materiality standard, or raise the threshold to a higher dollar amount. These and other recommendations are discussed more fully under "Disclosure Generally."

The Task Force also found unnecessary disclosure burdens in other areas. One example requires issuers making an exchange offer for the securities of a non-reporting company to provide audited financial statements of such company whether or not audited financials have been provided in the past. There is no apparent need for requiring the acquirer to provide more financial information about the target to the target's shareholders than the target's shareholders have been provided in the past. As discussed under "Significant Corporate Transactions," elimination of this requirement would both streamline disclosures in exchange offer registration statements and reduce the cost of preparing such documents.

## **II. Simplify Disclosure Formats**

A cornerstone of the securities laws is the requirement of full and fair disclosure. The prospectus -- the traditional offering document -- describes the company and its management and financial condition so that market participants can make an informed judgment about a company and its prospects in deciding whether to buy its securities. While prospectuses are indispensable sources of information for market professionals and therefore to the market, the reality is that these and other disclosure documents are often written in a manner that has been described as "turgid," "opaque" and "unreadable." Dense writing, with legal boilerplate and repetitive descriptions of the company, has become the standard convention.

One reason for this convention appears to be stylistic and formatting habits that have become entrenched by years of practice. It is undoubtedly easier to copy from previous disclosures than it is to formulate new and more effective ways to communicate with investors. The Commission's own rules -- for example, requiring certain disclosures to be presented in almost unreadable bold capital letters -- may have contributed to the problem. Fear of liability by companies and underwriters for omissions also may have created a bias towards repetitive and over-inclusive disclosures, with trivial information sometimes receiving as much attention as material information.

The Task Force recommends, as a first step, that the Commission adopt a new format for the opening pages of disclosure documents under the Securities Act of 1933 ("Securities Act") and tender offer documents under the Securities Exchange Act of 1934 ("Exchange Act"). The Task Force also urges the Commission to continue its plain-English initiatives and make other modifications to the disclosure rules to encourage disclosure that is both concise and more readable.

For prospectuses, the Task Force suggests that the dense and uninformative disclosure on cover pages be replaced with easy-to-read disclosure that would summarize important aspects of the offering. Today, the opening pages of prospectuses are dominated by boilerplate legal disclaimers. Under the Task Force's idea, the first few pages would answer the more common questions asked by investors, such as a description of the securities (including special features), identification of the issuer and underwriter, an explanation of why funds are needed, the offering price, the securities' trading symbol (if any) and any special characteristics of the offering, including risk factors. Two illustrations of possible formats are included in "Presentation of Information."

Similar problems of readability occur with documents used in extraordinary business transactions such as tender offer documents. Investors typically receive dense offering and transmittal documents that contain an overwhelming amount of information. The Task Force recommends that a standardized summary sheet be included on the inside cover of each Offer to Purchase. An outline of the information required and a sample summary also are included in "Presentation of Information."

### **III. Reduce the Costs of Securities Offerings**

#### Permit Delayed Offerings and Simplify Reporting By Smaller Companies

Over a decade ago, the Commission significantly for certain large publicly-traded issuers with three years of reporting history with the Commission. By introducing "shelf registration" for primary offerings of securities by these issuers, the Commission permitted certain relatively large, seasoned companies to sell some or all of the securities under an already effective registration statement at a time of their own choosing. In 1992, the Commission reduced the reporting period and market float requirements of Form S-3 and thereby extended benefits of shelf registration to a wider variety of issuers. This flexibility allowed such companies to take advantage of perceived "market windows."

The Task Force recommends that a modified shelf registration procedure be provided to smaller companies that have filed timely public reports with the

Commission for at least 12 months. This would provide approximately 4,800 companies with greater flexibility with respect to the timing of their offerings.

The Task Force also recommends permitting these smaller companies to deliver certain prior periodic reports to prospective investors instead of repeating similar information in the prospectus. This delivery method, now used by companies filing on Forms S-2/F-2 and reporting for 36 months, saves printing and other costs and results in a streamlined transaction. The Task Force believes that this delivery method should be expanded to issuers timely reporting for at least 12 months and using Forms S-1/F-1 (which will render Forms S-2/F-2 superfluous).

These proposals are discussed in more detail under "Facilitating Capital-Raising."

#### Exempt Certain Small Local Offerings

Under Regulation A, small companies may publicly up to five million dollars worth of unregistered securities within a 12-month period by way of a short-form offering circular. When it created this exemption, the Commission recognized that the costs of registration may otherwise effectively preclude such smaller offerings. The Task Force recommends that this exemption be liberalized to permit an eligible company to raise five million dollars within each 6-month period, rather than each 12-month period. This exemption would be of particular assistance to a rapidly growing, small company.

Another existing exemption that is advantageous for small businesses permits certain unregistered offerings within the borders of a single state relaxing the restrictions in the Commission's safe harbor rule, rule 147, to make the exemption more useful to smaller companies. In addition, the Task Force recommends that the Commission adopt a "regional" exemption for offerings up to five million dollars that cross state lines but remain within a prescribed regional area. This exemption would permit offerings in a metropolitan area that is not contained within a single state. A fuller discussion of these proposals is included under "Small Business Initiatives."

Some of these recommendations that affect small business will be of interest to state securities regulators; the Commission should follow its normal practice of coordinating such initiatives with the states.

#### Seasoned Issuers

The Report includes several recommendations to reduce costs of registration and enhance timing flexibility for larger, more seasoned issuers, such as permitting shelf registrants to register dollar amount of offerings without any

description of the securities to be offered and deferring payment of filing fees until the time of the actual offering. These and similar recommendations are described in "Facilitating Capital-Raising."

#### **IV. Simplify Other Regulatory Requirements**

In addition to the reforms designed to reduce costs of registration, the Task Force has sought to identify rules and requirements that may have unnecessarily affected decisions in the capital-raising process or caused unnecessary compliance costs.

##### Overhaul the Rules on Trading During a Securities Distribution

Few rules have resulted in more day-to-day effort by securities firms and by Commission staff than the rules regulating purchases by an issuer or underwriter during a securities distribution (Exchange Act Rules 10b-6, 10b-6A, 10b-7, and 10b-8). Few would take issue with their purpose: to protect the integrity of the offering process by precluding interested parties from activities influencing the market price for the offered security. But few, also, would dispute that these "trading practices rules" have become unnecessarily complicated and, in many respects, outdated.

The Task Force recommends a wholesale revision of the "trading practices rules" with a new regulation that would be narrower in scope and easier to understand and follow. Among other things, the new rules would establish separate requirements for issuers and other distribution participants, and in the case of underwriters and broker-dealers, exempt actively-traded securities, permit a greater range of activities by distribution participants, make an exception for de minimis transactions, and substantially reduce the rule's application to debt securities. The new regulation also would broaden the opportunities for permissible passive market-making and provide more flexibility for stabilizing transactions. Finally, the Task Force recommends rescission of Rule 10b-8 entirely, which covers rights offerings.

These recommendations are discussed in greater detail under "Trading Practices Rules."

##### Place Exchange Tender Offers on the Same Timetable as Cash Tender Offers

Today, a cash tender offer can be commenced immediately upon filing appropriate disclosure documents. A tender offer that includes securities rather than cash, however, must wait until a registration statement relating to the offered securities is filed, possibly reviewed by Commission staff, and declared effective before the offer can be commenced. The Task Force recommends that

most registration statements relating to exchange tender offers filed by seasoned issuers eligible to use the short form registration statements, Forms S-3/F-3, be deemed effective automatically upon filing. This recommendation, discussed more fully under "Significant Corporate Transactions," would place such exchange tender offers on the same footing as cash tender offers. Just as with the current practice involving cash tender offers, exchange offer registration statements would remain subject to post-effective review by Commission staff.

## **V. Securities Act Concepts**

The statutory framework of the Securities Act, which has served the financial markets well for over 60 years, currently is being reexamined in light of the constant evolution of today's capital markets. A number of initiatives have been undertaken by the Commission, Congress, state regulators and the private sector to reassess the continuing effectiveness of the Securities Act registration, prospectus delivery and other requirements.

The rapidly evolving world in which we live is placing many strains on the system. Technological developments and globalization, for example, have made securities regulation today quite different from 1933. Many other strains exist as well.

A number of approaches to address some or all of the strains currently are being debated. These include the global alternative of "company registration" being considered by the Advisory Committee on the Capital Formation and Regulatory Processes chaired by Commissioner Steven M.H. Wallman, and less global alternatives, such as narrowing the definition of "offer," which would allow issuers to "test the waters" for interest without the cost of full-blown registration; or permitting a "pink herring" registration, an alternative to the previous approach, that would require companies to file a simplified registration statement in order to "test the waters."

Pending further consideration of all of the alternatives, the Task Force recommends a quick fix dealing with "integration" of private and public offerings to avoid unnecessary frictions for issuers in their capital-raising activities as well as other initiatives for seasoned issuers.

A discussion of possible alternative approaches, as well as specific recommendations, is included under "Securities Act Concepts."

\* \* \* \* \*

These and many other recommendations are discussed in more detail under the following thirteen tabs: Elimination of Rules and Forms; Presentation of

Information; Securities Act Concepts; Facilitating Capital-Raising; Small Business Initiatives; Significant Corporate Transactions; Registration; Reporting; Disclosure Generally; Trading Practices Rules; Accounting Disclosure Changes; Technical Changes; and Other Current Commission Initiatives.

## **I. ELIMINATION OF RULES AND FORMS**

This section includes Task Force recommendations that focus on ways to streamline the non-financial disclosure rules. In some cases, the Task Force recommends eliminating forms or rules that no longer serve a significant purpose, because more recent regulatory initiatives by the Commission have rendered them outdated and superfluous. In other instances, the Task Force recommends eliminating rules or forms that impose disclosure requirements that are overly burdensome by comparison with the utility of the disclosures elicited.

### **A. SECURITIES ACT REGULATIONS**

#### **1. Eliminate Regulation B (Rules 300-346), and accompanying Schedules A, B, C, and D, and Forms 1-G and 3-G, which provide a limited exemption for certain interests in oil or gas rights, due to its limited use and the availability of more beneficial exemptions.**

Regulation B provides a conditional, limited exemption from Securities Act registration for offerings of "fractional undivided interests" in oil or gas rights of up to \$250,000 per offering. The Commission originally enacted Regulation B in 1963 and last revised it substantially in 1972.

In order to obtain the Regulation B exemption, an offerer of fractional undivided interests in certain specified oil or gas rights must file an offering sheet with the Commission at least ten days prior to commencing the offering. The offering sheet must contain the information specified by Schedules A, B, C, or D, depending on the distinct type of oil/gas interest, as well as on whether the enterprise is producing or non-producing. These schedules require detailed information concerning the nature and amount of the interests offered; a discussion of the legal rights and obligations created by such interests; a description of the property in question; for producing interests, a history of the oil/gas production activities in the field in question; and, for non-producing interests, a description of plans for the drilling of wells, including the estimated costs and method of financing such drilling. Regulation B does not require any offerer to furnish current or past financial statements.

Regulation B also requires an offerer to submit two post-offering reports: Form 1-G and Form 3-G. Form 1-G, which is filed with the Commission, requires disclosure of information pertaining to each sale of the offered securities. Form 3-G, which is sent to each purchaser, as well as filed with the Commission, must disclose more detailed information pertaining to the offering's results, including the actual cost of drilling and expenses incurred in the selling effort.

Between 1966 and 1977, the Commission received 6,904 Regulation B filings. This relatively large number of Regulation B filings corresponded with an increase in oil/gas drilling activity and related financing triggered by the energy crisis of the mid-1970s. In 1975 alone, the Commission received 625 Regulation B offering sheets pertaining to \$35.4 million in total sales.

However, by 1977 the number of Regulation B offering sheets filed with the Commission had dropped to 96, covering only \$7.3 million in aggregate sales of oil/gas securities. Since then, the number of Regulation B offering sheets filed has steadily declined, from 94 such filings in 1980, to 13 in 1985, seven in 1990, four in 1992, and, finally, zero in 1995. Moreover, since enactment of Regulation B's reporting requirements in 1972, the Commission has received only one each of Form 1-G and Form 3-G.

The decrease in submissions may be due to a decrease in small scale oil/gas ventures occurring in the United States since the end of the 1970s energy crisis, as well as the availability of other exemptions, such as the limited offering exemptions from registration set forth in Regulation D, or the private placement exemption under Section 4(2) of the Securities Act. Of these exemptions, Rule 504 of Regulation D probably offers the most benefits to the small oil or gas issuer. There are several reasons why such an issuer, which is not an Exchange Act reporting company, would elect to proceed under Rule 504 rather than Regulation B when claiming an exemption for an offering of fractional undivided oil or gas interests. First, under Rule 504, an offerer can claim an exemption for a maximum amount of securities that is four times greater than that allowed under Regulation B (\$1,000,000 compared to \$250,000). Second, the Rule 504 exemption is not conditioned on specific disclosures other than the notice filing of Form D (which the Task Force proposes to eliminate). Third, while Rule 504 is available for an offering of fractional undivided interests in an oil or gas limited partnership, Regulation B is unavailable for such an offering.

Given the current lack of use by small oil/gas financiers of the Regulation B exemption, the availability of a more flexible exemption under Rule 504, and the potential availability of other limited offering exemptions with higher dollar limits, retention of this exemption with its disclosure requirements serves little purpose. Accordingly, the Task Force recommends the elimination of Regulation B in its

entirety, along with the elimination of Schedules A, B, C, and D, and Forms 1-G and 3-G.

**2. Eliminate Regulation E (Rules 601-610) and accompanying Forms 1-E and 2-E, which relate to a limited exemption for certain types of investment companies designed to aid small businesses, or incorporate Regulation E within Regulation A.**

Regulation E provides an exemption from registration under the Securities Act for small offerings of securities issued by two types of investment companies: small business investment companies ("SBICs") and business development companies ("BDCs"). Regulation E was adopted in 1958, shortly after the enactment of the Small Business Investment Act of 1958 ("SBIA"), and was extended to BDCs in 1984. Both types of companies were authorized by Congress in order to stimulate the flow of capital to small businesses.

SBICs were authorized pursuant to the SBIA. Their activities are limited to investing in small businesses by purchasing securities and making loans. Such investments are facilitated by the Small Business Administration, which is authorized to license SBICs and to provide or guarantee loans to SBICs at favorable rates. BDCs are investment companies that are regulated under specific provisions under the Investment Company Act of 1940 ("Investment Company Act"). BDCs must make specific types of investments in small businesses, as well as provide significant managerial assistance to the companies in which they invest.

Regulation E has been used infrequently. The Commission has received a total of only 40 Form 1-E filings by 14 investment companies, with all but eight of these filings made prior to 1985 and only one since 1990. Furthermore, since Regulation E's inception, the Commission has received only four Form 2-E filings.

There may be several reasons for Regulation E's limited use. First, the five million dollar limit on offerings under the Regulation E exemption may tend to discourage its use. Many SBICs and BDCs may prefer instead to conduct private placements or registered public offerings, which are not subject to this limitation. Second, Regulation E is available only to those SBICs that are registered investment companies. Most SBICs, however, elect to avoid registration as investment companies by meeting the exception in Investment Company Act Section 3(c)(1) for any issuer that has fewer than 100 beneficial owners and does not make a public offering. Unregistered SBICs therefore may not avail themselves of Regulation E even if it were available, since such an offering, if made to the public, may result in the loss of the exemption from Investment Company Act registration.

Another reason for the disuse of Regulation E may be that the same form that a SBIC must file to register under the Investment Company Act (Form N-5) can also be used by the SBIC to fulfill its Securities Act registration requirements. Because of the convenience afforded by Form N-5's dual function, a SBIC that intends to register under the Investment Company Act is more likely to register an initial public offering of securities on Form N-5.

The Commission's experience with Regulation E suggests that there does not appear to be any need for a small offering exemption for SBICs and BDCs. Consequently, the Task Force recommends eliminating Regulation E and the two forms that are required to be filed with the Commission in connection with its use, Forms 1-E and 2-E.

Alternatively, the Task Force recommends that the Commission consider eliminating Regulation E and expanding the Regulation A exemption to include registered SBICs and BDCs. This approach has two advantages. First, the Commission could, at the same time, consider ways to make unregistered small offerings more attractive to SBICs and BDCs by, for example, extending Regulation A's \$1,500,000 limit for selling securityholder resales to these issuers. The Task Force's recommendation to amend Regulation A to permit issuers to raise five million dollars during any six month period rather than five million dollars per year also may benefit registered SBICs and BDCs. Second, while Regulation E differs from Regulation A in certain respects that are attributable to special characteristics of SBICs and BDCs, the Task Force believes that amending Regulation A to accommodate registered SBICs and BDCs would be relatively easy to accomplish.

### **3. Eliminate Regulation F (Rules 651-656) and accompanying Form 1-F, pertaining to a limited exemption for assessments levied on assessable stock and for resales of forfeited assessable stock, because the adoption of Rule 504 has significantly reduced the Regulation's utility.**

Regulation F provides a conditional limited exemption from Securities Act registration for assessments levied on assessable stock and for resales of forfeited assessable stock. The Commission promulgated Regulation F in 1959 at the same time that it enacted Securities Act Rule 136. Rule 136(c) defines "assessable stock" to mean "stock which is subject to resale by the issuer ... to the event of a failure of the holder of such stock to pay any assessment levied thereon." Thus, assessable stock is stock the purchase of which triggers an annual obligation to pay an amount, termed an "assessment," to the issuer in addition to the original offering price. If the buyer fails to pay the levied assessment after receiving a notice of delinquency from the issuer, the issuer can reclaim the original stock and resell it, usually at an auction.

Under Rule 136, both the levying of an assessment on assessable stock and the resale of forfeited assessable stock constitute the issuance of securities, which trigger registration requirements under the Securities Act. Regulation F establishes a partial conditional exemption from registration for these transactions. In order to qualify for the exemption, a company must be incorporated or have its principal business operations in the United States. In addition, a company cannot claim more than \$300,000 in exempted assessable stock transactions for any one calendar year.

A company also must file a Form 1-F with the Commission's regional office closest to its principal business operations at least 10 days prior to levying any claimed exempted assessment or sale of delinquent assessable stock. Form 1-F requires disclosure of pertinent information about the issuer; its 10 percent beneficial stockholders; its directors and officers; its levied assessments, resales of forfeited assessable stock, and other unregistered securities issued during the preceding year; and its current proposed assessments or resales of forfeited assessable stock.

Historically, only two types of companies have issued assessable stock: mining companies and water extraction/delivery companies, also known as mutual water companies. Since the promulgation of Regulation F, approximately 40 such companies have filed a total of 234 1-F forms. Most of these filings occurred between 1967 and 1982. Only 32 Form 1-F filings have occurred between 1983 and 1995. Ten companies were responsible for those filings. Since 1992, only three companies have filed a total of 10 1-F forms with the Commission.

The primary reason for the recent steady decline of Form 1-F filings appears to be the availability of more beneficial limited offering exemptions, particularly the Rule 504 exemption. Virtually all Regulation F companies have been non-reporting companies eligible to claim a Rule 504 exemption. In 1982, the Commission adopted its first version of Rule 504. Following that year, the annual number of Form 1-F submissions steadily decreased from nine in 1982, to six in 1983, three in 1984, zero in 1985 and 1986, and an average filing rate of two to three for the years 1987 to 1995.

There are several reasons why an assessable stock issuer would seek to proceed under Rule 504 rather than Regulation F. First, it would receive a higher annual dollar limit (\$1,000,000 compared to \$300,000). Second, Rule 504 posits no informational requirements. Third, the Rule 504 exemption is available for new issues as well as assessments and sales of forfeited assessable stock. Therefore, given the lack of filings under Regulation F and the availability of the broader Rule 504 exemption, the Task Force recommends that the Commission eliminate Regulation F in its entirety, along with its accompanying Form 1-F.

## **B. OTHER SECURITIES ACT RULES**

### **1. Eliminate Securities Act Rule 148, which sets forth a safe harbor for resales made under the repealed Bankruptcy Act, because the rule has become outdated.**

Rule 148 was originally designed to be a counterpart to Rule 144 and to provide a safe harbor for the resales of certain categories of securities acquired in bankruptcy proceedings, including securities issued under the federal Bankruptcy Act, portfolio securities sold under the Securities Investors Protection Act (SIPA), and where the Federal Deposit Insurance Corporation (FDIC) has been appointed receiver of the debtor's assets.

In 1978, the federal Bankruptcy Act was repealed and replaced with the Bankruptcy Code, which provides an exemption from Securities Act registration as well as a safe harbor for the resales of securities received under a plan of reorganization. Through no-action letters, the Commission has taken the position that Rule 148 is applicable only to resales of securities that were issued under the repealed Bankruptcy Act, and not to resales of securities subject to the new Bankruptcy Code. Consequently, Rule 148 appears to be outdated and should be eliminated.

### **2. Combine Rules 152a and 236, both of which relate to fractional shares, and adjust the dollar cap under Rule 236 to account for inflation.**

Rules 152a and 236 relate to fractional interests. Rule 152a applies when fractional interests resulting from a stock dividend, stock split, reverse stock split, conversion, merger or similar transaction are combined and sold. The rule clarifies that the offer and sale of the combined fractional interests is deemed to be a transaction by persons other than an issuer, underwriter or dealer under Section 4(1) of the Securities Act, even if the transaction is effected on behalf of the security holders by the issuer or an affiliate of the issuer or by a bank or other independent agent.

Rule 236 relates to situations in which issuers sell stock in order to obtain funds to pay shareholders cash in lieu of fractional interests in connection with a stock dividend, stock split, reverse stock split, conversion, merger or similar transaction. Rule 236 provides that the sale of stock for that purpose is exempt from registration provided certain conditions are met, including that the issuer is a reporting company; that the aggregate gross proceeds from the sale of all shares offered in connection with, the transaction for the purpose of providing such funds do not exceed \$300,000; and that at least ten days prior to the offering of

the shares, the issuer furnishes to the Commission in writing certain information about the transaction.

The Task Force recommends that Rule 236 be merged with Rule 152a and that Rule 236 then be eliminated. As a result, companies considering the treatment of fractional interests need only consult one rule.

The Task Force also recommends that, in conjunction with merging the rules, the Commission eliminate the reporting requirement in Rule 236 and increase the \$300,000 cap to \$600,000. The \$300,000 cap was established in 1982. That number, converted to current dollars based on the CPI-U Index, would be approximately \$560,000 today.

### **3. Eliminate Securities Act Rules 445, 446, and 447, which relate to securities offered through competitive bidding, because these rules have become obsolete.**

The Task Force recommends eliminating Rules 445, 446 and 447, which govern registration statements filed in connection with securities to be offered through competitive bidding (e.g., by means of a solicitation of competitive proposals from underwriters). These rules were promulgated in the late 1940s principally to accommodate registered public utility holding companies and their subsidiaries ("registered holding companies"). These companies were subject to Rule 50 under the Public Utility Holding Company Act of 1935 ("PUHCA"), which required that their securities be sold through competitive bids.

Rules 445, 446 and 447 appear to be rarely used at present and are unlikely to be used in the future. A review of Commission filings shows that there was only one competitive bid filing in 1994, and no competitive bid filings in 1995. One reason for the lack of filings under these rules may be that, beginning in 1982, the Commission began to relax the rigid bidding requirements of PUHCA Rule 50 in recognition of the fact that these procedures often precluded registered holding companies from obtaining the benefits of the Securities Act Rule 415 shelf registration procedure, placing them at a disadvantage compared to other issuers in getting access to the capital markets on short notice. In 1994, the Commission determined that competitive bidding was no longer necessary to prevent abuses in the issuance and sale of securities by these companies and rescinded Rule 50.

In recommending this course of action, the Task Force does not intend to preclude an issuer from undertaking a competitive bidding process, which will continue to be permissible under other existing rules.

#### **4. Eliminate Rule 494, which relates to newspaper prospectuses of foreign government securities, because the rule has become outdated.**

Rule 494 was adopted in 1951 to accommodate a then common practice of advertising securities issued by foreign national governments. The rule limits such "newspaper prospectuses" for foreign government securities to advertisements appearing in newspapers, magazines and other periodicals that are distributed by second class mail. However, the practice appears to have fallen into disuse. The Task Force believes that this rule is outdated and should be eliminated.

### **C. EXCHANGE ACT RULES**

Two exemptions from the short-swing profit recovery provisions of Section 16(b) of the Exchange Act do not appear to serve a useful function. Both were crafted in another era to address very narrow circumstances. While the staff is not able to monitor when these exemptions are used, the available evidence suggests that such use is rare. Thus, the Task Force recommends that these provisions be eliminated.

#### **1. Eliminate paragraph (c) of Exchange Act Rule 16b-1, which pertains to the acquisition of securities resulting from a railroad or other carrier reorganization approved by the Interstate Commerce Commission.**

Paragraph (c) of Rule 16b-1 exempts from Section 16(b) the acquisition of securities resulting from a reorganization of a railroad or other carrier approved by the Interstate Commerce Commission, an agency that was abolished as of January 1, 1996. The function of approving such reorganizations has now been transferred to the Surface Transportation Board, an independent agency of the Department of Transportation.

The Task Force recommends that the Commission consider eliminating this paragraph since the security to be received in the reorganization is likely to be of a different class than that surrendered, whereas only securities of the same class or securities that are convertible into such class (e.g., equity-based derivatives) are matchable under Section 16(b).

These recommendations should be viewed together with other initiatives concerning rules under Section 16(b) which are discussed in "Other Current Commission Initiatives."

#### **2. Eliminate Exchange Act Rule 16b-4, which pertains to certain holding company redemption transactions, because the rule is of marginal utility.**

It is an unusual situation where a holding company owns securities in only one company and desires to exchange its own shares through a redemption for those of that one company. It is this type of transaction that is protected from Section 16(b) by Rule 16b-4, if the Rule's conditions are met. Like Rule 16b-1(c), this Rule does not appear to be used. Moreover, it also exempts an exchange of one class of securities, or securities that are convertible into such class (e.g., equity-based derivatives), for another class of securities -- a transaction not likely subject to Section 16(b) in any event. As such, the Task Force recommends that Rule 16b-4 be eliminated.

#### D. FORMS

##### **1. Consider eliminating the Form D filing requirement under Regulation D and Section 4(6) of the Securities Act because the requirement has outlived its usefulness.**

The Commission currently requires the filing of Form D by an issuer that engages in an unregistered offering of its securities in reliance on an exemption under Regulation D or Section 4(6) of the Securities Act. An issuer also may utilize the form to give notice its reliance on the Uniform Limited Offering Exemption ("ULOE") for its securities offering exemption in those states that have adopted ULOE and Form D. For each claimed exempt offering, an issuer must file a Form D with the Commission no later than 15 days after the offering's first sale of securities. Form D requires the issuer to disclose basic information concerning the identity of the issuer and the offering, including information regarding the offering price, number of investors, expenses involved, use of proceeds and the exemption claimed.

The Task Force recommends that the Commission, in consultation with North American Securities Administrators Association, Inc. ("NASAA"), consider the continued need for a Form D filing requirement with the Commission. The Commission does not require an issuer to file a notice when making offerings under other exemptions from Securities Act registration, such as an intrastate offering under the Rule 147 safe harbor. Furthermore, with the curtailing of Form D's notice requirement in 1986, a current Form D typically provides only minimal information about the filer and the claimed exempt offering. Similar information regarding unregistered sales is currently required by Item 701 of Regulations S-K and S-B, which applies to an issuer registering an initial public offering or other offering of securities on Form S-1, as well as to a foreign private issuer registering an offering of securities on Form F-1. In addition, the Commission recently proposed to require the disclosure of Item 701 information on a quarterly

basis concerning the unregistered sales of equity securities, regardless of the exemption claimed. See Release No. 33-7189 (June 27, 1995).

If Form D were to be eliminated, Rules 503 and 507 also should be eliminated. Rule 503 sets forth the notice filing requirement for issuers claiming a Regulation D exemption. Rule 507 provides that an issuer is ineligible to claim a Regulation D exemption if it has previously been subject to a court order for failing to comply with Rule 503.

## **2. Eliminate Form SR and, instead, require the use of proceeds following initial public offerings to be reported on Exchange Act reports.**

Securities Act Rule 463 requires issuers to report on Form SR the use of proceeds following an initial public offering within ten days of the first three months following the effective date of the registration statement, and every six months thereafter, until the offering has been terminated or all proceeds have been applied. In 1994 and 1995, 2,103 and 1,635 such filings were made, respectively.

The Task Force recommends the elimination of Form SR in favor of requiring first-time issuers to report the use of proceeds on their first Exchange Act report after effectiveness and thereafter on their Exchange Act reports (e.g., quarterly reports) through the termination of the offering or application of the proceeds. This consolidation of disclosure requirements would facilitate reporting by registrants, who would have to comply with fewer forms in satisfying their substantive reporting obligations. Furthermore, these important disclosures regarding the use of proceeds and the progress of the offering would appear within a filing that is more easily monitored by investors.

If the proposal to eliminate Form SR is adopted, Rule 463 of Regulation C, which relates to the reporting of use of proceeds, should be revised to reflect the proposed changes.

## **3. Eliminate Exchange Act Form 8-B, regarding registration of securities of successor issuers, because Exchange Act Rule 12g-3 has rendered the form largely superfluous.**

The Task Force recommends the elimination of Form 8-B. This form was adopted in 1936 to provide for registration of securities of certain successor issuers under Section 12 of the Exchange Act. An issuer uses Form 8-B to register its securities in the situation where the issuer does not have securities registered under Section 12 of the Exchange Act, but has succeeded to an issuer that had securities registered under Section 12 at the time of the succession.

The Commission received only 59 Form 8-B filings in 1994 and 58 such filings in 1995. Form 8-B has been rendered largely superfluous by the application of Exchange Act Rule 12g-3 to successor issuers. In the event of a succession by merger, consolidation, exchange of securities, or acquisition of assets, Rule 12g-3 deems to be registered under Section 12 of the Exchange Act the equity securities of an issuer not previously registered under Section 12 that are issued to the holders of equity securities registered pursuant to that section. Hence, a successor to an issuer with a class of securities registered under Section 12 is deemed to succeed to that registration and need not file a Form 8-B.

In order to accommodate the elimination of Form 8-B, the Task Force recommends expanding Rule 12g-3 to include any transactions or securities that are currently covered by Form 8-B, but not Rule 12g-3. In addition, the Task Force suggests clarifying in Rule 12g-3 the staff's position that the rule applies to issuers with securities registered under Section 12(b) of the Exchange Act, as well as to those with securities registered under Section 12(g). Consistent with current staff practice, the successor issuer would be required to file a current report on Form 8-K with respect to the transaction and subsequently comply with all the applicable provisions of the Exchange Act.

#### **4. Eliminate Form 10-C and Rules 13a-17 and 15d-17, which require issuers registered under the Exchange Act and quoted in Nasdaq to report certain corporate events to the Commission and the NASD.**

The Task Force recommends elimination of Rules 13a-17 and 15d-17, as well as related Form 10-C, since the information required to be reported on Form 10-C is already reported on a more detailed basis with the Commission under existing reporting rules.

Under Rules 13a-17 and 15d-17, issuers that are registered pursuant to Section 12(g) or subject to Section 15(d) and quoted in Nasdaq are required to file a Form 10-C to report any aggregate increase or decrease in the amount of securities of such class which exceeds five percent of the amount of the class outstanding as last reported, or to report changes in their corporate name. In 1994 and 1995, 1,515 and 1,635 filings were made, respectively.

The rules requiring the filing of Form 10-C were adopted in 1971, shortly after the Nasdaq automated system became operational, in order to provide the NASD with more timely notice of certain events to help in its administration of the new Nasdaq system and its publication of daily price indexes. The Task Force believes that Form 10-C has outlived its usefulness as a Commission filing and therefore could be eliminated without any loss of information to the market or harm to investors in Nasdaq quoted companies. In this regard, the Task Force

notes that companies whose equity securities are registered under Section 12(g) with the Commission must file all Exchange Act reports with the Commission.

**5. Eliminate the exhibit requirements of Form 11-K that provide little information that is not otherwise available to plan participants.**

Issuers that have registered interests in employee stock purchase, savings and similar plans under the Securities Act are required to file annual reports with respect to such plans on Form 11-K. The Task Force recommends that the Commission eliminate the exhibit requirements of Form 11-K. The exhibits provide little information that is not otherwise available to plan participants, and the Task Force understands that the exhibit requirements are particularly burdensome to registrants.

The Commission alternatively should consider eliminating the Form 11-K requirement for ERISA plans. Much of the information elicited by the form relates rather narrowly to the plan and its management, rather than to the registrant and its financial condition. The key element of Form 11-K, for example, is the plan's audited financial statements. However, plan management is principally a concern of laws other than the securities laws (i.e., ERISA).

In considering this recommendation, the Commission should take into account that plan financial statements included in Form 11-K typically are incorporated by reference into a registration statement on Form S-8. The Commission also should consider whether any relief resulting from this recommendation should be extended to plans that are not covered by ERISA.

**6. Eliminate Items 3(e) and 4(a) of Form F-6, governing the registration of American Depositary Receipts, because the elicited information appears to be rarely used.**

Item 3(e)

Item 3(e) of Form F-6 requires the registrant to include, as an exhibit, the name of each dealer known to the registrant who has deposited shares against issuance of American Depositary Receipts, proposes to deposit shares or participated in a plan to deposit shares, within the past six months. The Task Force recommends that this item be eliminated because the required information appears to be of little use to the marketplace. In addition, because the base number of outstanding shares is not normally publicly available, the information regarding semi-annual adjustments to that number appears to be of little use.

Item 4(a)

Under current rules, a registrant on Form F-6 must undertake to provide semi-annual updated information generally concerning dealers depositing shares in the facility and the number of shares issued/cancelled during the covered period. The Task Force recommends elimination of this requirement, embodied in Item 4(a), because the required information appears to be of little use to the marketplace. In addition, because the base number of outstanding shares is not normally publicly available, the information regarding semi-annual adjustments to that number appears to be of little use.

## **II. PRESENTATION OF INFORMATION**

From the investor's prospective, disclosure may not be effective unless it is understandable, complete and timely. Fulfillment of each of these goals sometimes may be hindered by current practices in drafting documents. These goals, and suggestions for better achieving them, are discussed more fully below.

### **A. CLEAR AND ACCURATE DISCLOSURE**

#### **1. Develop a "plain English" introduction to the prospectus to enhance its readability by individual investors, by eliminating boilerplate "legalese" and requiring a summary of key information.**

The U.S. securities markets are built upon the foundation of full and fair disclosure. The prospectus, the basic disclosure document used to sell securities in public offerings, contains information about the issuer, including its business, its management and financial condition, enabling market participants to make informed judgments about a company and its prospects. The prospectus also contains information specific to the offering such as risk factors, use of proceeds, the terms of the securities and the underwriting arrangement. Availability of this information has played a significant role in the success of the U.S. capital markets and confidence in their integrity.

As a practical matter, however, prospectuses often are far more useful to the professional investor than to most retail investors. While prospectuses contain certain complex material often relating to the description of securities, even basic information about an issuer's business is written in a way that has been described as "turgid," "opaque" and "unreadable." Drafters claim that this dense writing style stems in part from an effort to meet the high standard of diligence under the Securities Act that is imposed on companies, management and underwriters with respect to the adequacy and accuracy of disclosures provided to investors. Issuers, underwriters and their lawyers produce defensively written documents that put a premium on legal jargon and over-inclusive disclosures.

Trivial points sometimes receive as much attention as material information, and in the end may bury points significant to an investment decision. In the eyes of many, today's prospectus has become a legal document to shield against liability, rather than a useful and informative disclosure document, as contemplated by the Commission's current "plain English" rule, Rule 421 of Regulation C under the Securities Act and case law. See e.g., *McMahan & Co. v. Warehouse Entertainment Inc.*, 900 F.2d 576 (2d Cir. 1990), cert. denied, 501 U.S. 1249 (1991); *In re Franchard Corp.*, Release No. 33-4710, [1964-1966 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 77,113 (July 31, 1964). This unfortunate result especially is evident with respect to offering documents relating to initial public offerings and complex transactions. As Chairman Levitt recently observed, "our passion for full disclosure has created fact-bloated reports and prospectuses that are more redundant than revealing."

The Task Force believes that issuers, management and underwriters should begin drafting and using "plain English" offering materials. As a first step, the Task Force briefly sets forth below its recommendations for presenting information on the front cover, inside cover and first page or back cover of a prospectus. The Task Force also suggests the use of a "plain English" glossary to explain technical terms used in the document. Further, the Task Force recommends that the Commission consider publishing an interpretive release to assist in the preparation of "plain English" disclosure documents by every issuer; a release similar to that published in 1991 with respect to the importance of clear, concise and comprehensible disclosure in offering materials used by limited partnerships and other direct participation investment programs. See Release No. 33-6900 (June 17, 1991).

Prospectus Cover. The Task Force recommends eliminating many of the legal warnings on the cover page. In their current form, these warnings often convey little useful information, and, because they are written in dense capital letters, also are virtually unreadable. Instead, the cover should be more inviting to the reader, and legal warnings that continue to be necessary should be set forth in a more readable style and format.

Inside Cover. The Task Force believes that the inside cover should be required to contain a table of contents and summary financial information, either in tabular or graphic form, which the issuer and underwriter believe would be useful to a potential investor.

First Page or Back Cover. The Task Force recommends a format that, in addition to basic information about the issuer, would include: (i) a summary paragraph of key points of interest (including a characterization of risk); and (ii) a tabular presentation of features of the offering, such as the exchange where the securities are traded, company dividend policy, etc. The Task Force also

recommends that the Commission consider requiring the tabular presentation to include certain items that are not now required, but which may assist investors in understanding the offering, such as the effect of dilution (which is now required only in initial public offerings) and certain significant financial ratios.

Other Presentation Suggestions. The Task Force recommends that the Commission clarify that disclosure regarding the risks of the offering pursuant to Item 503 of Regulation S-K must be set forth in full in the forepart of the prospectus and cannot be incorporated by reference from other filings or portions of the document.

Samples. Included at the end of this section are two illustrations of the first few pages of a prospectus in a more plain English format.

**2. Require a "plain English" summary sheet in tender offer statements, which would function as a "road map" by providing shareholders with answers to commonly asked questions about the offer.**

In connection with a tender offer, shareholders are furnished with a disclosure document known as an "Offer to Purchase," which provides information about the bidder, the terms and conditions of the offer and the procedures for tendering shares required by Exchange Act Regulations 14D and 14E or Rule 13E-4. These documents often are quite lengthy and contain technical and legal terms not commonly understood by the reader. The Task Force recommends that the Commission include tender offer materials within its plain English initiatives so as to make these lengthy, complex and legalistic documents more understandable.

One suggestion to facilitate shareholder comprehension of the essential terms and provisions of the offer is the use of a glossary to explain technical terms used elsewhere in the tender offer materials. Another idea is a "plain English" summary. This summary, which would begin on the inside cover page of the Offer to Purchase, would provide investors with a ready reference to certain basic information about the offer. The information would be presented as responses to common shareholder questions, such as the following:

- Who is the person offering to buy the securities?
- What are the classes and amounts of securities being sought?
- How much is the bidder paying and what will be the form of payment?
- Is information on the bidder's financial condition relevant to my decision whether to tender?

- How long do I have to decide whether to tender?
- What are the most significant conditions to the offer?
- How do I tender my shares?
- How may I withdraw my tendered shares?
- If the transaction is a consensual one, what does my board of directors think of this offer?
- Is this the first step in a going private transaction?
- Will this tender offer be followed by a merger if not all of the company's shares are tendered?
- If I decide not to tender, how will the tender offer affect my shares?
- What is the market value (if traded) or the net asset or liquidation value (if not traded) of my shares?
- Who can I talk to if I have questions about the offer?

Each of the items briefly described in the summary would reference a more detailed discussion elsewhere in the tender offer materials. Bidders also would provide a statement at the bottom of the summary to the effect that the Offer to Purchase must be reviewed in its entirety for a full understanding of the offer.

An example of a sample summary relating to a "plain vanilla" cash tender offer is included at the end of this section. Of course, the exact contents of the summary will depend upon the structure and terms of the particular transaction. For instance, a summary relating to a tender offer for limited partnership interests would have to include summarized risk factor disclosure in bullet point format, as well as highlight conflicts of interests faced by general partners and other affiliates in making the offer.

The Task Force also recommends that the Commission consider whether a summary should be required in any solicitation or recommendation by the target company to the holders of the security to accept or reject the tender offer.

**3. Allow registrants to include earnings releases, which often are written in "plain English," in their quarterly reports, thereby making such reports more readable and easier to prepare.**

The Task Force recommends permitting registrants to use quarterly earnings releases in place of, or in conjunction with, the quarterly report on Form 10-Q. Quarterly earnings releases typically are issued shortly after the end of the quarter, before the Form 10-Q is prepared. In addition to quarterly financial information, earnings releases often include a narrative discussion of other material developments that, unlike the filing on Form 10-Q, is typically in a "plain English" format.

The Commission should permit companies to file their earnings releases under cover of a Form 10-Q, provided that such releases and any accompanying disclosures contain all of the information required by the form. Other than requiring that Management's Discussion and Analysis be set forth in a single coherent discussion in accordance with applicable Commission and staff positions, there would be no restrictions on the format or order in which information is presented, so long as the presentation is balanced, informative and easily understood.

This recommendation should enhance the readability of quarterly information since earnings releases usually are written in a clear, less legalistic manner than the required Form 10-Q. At the same time, the recommendation may reduce the regulatory burden on registrants, who will be spared the requirement to re-order quarterly information in the format required by Form 10-Q. The Task Force notes that this recommendation is not intended to lessen the quality of disclosure, and recognizes there is a risk that this idea possibly could result in the preparers of earnings releases switching to a more formalistic document -- a result that should be avoided since it would defeat the "plain English" goal.

## **B. UNEVEN DISCLOSURE**

Apart from the need for plain and simple disclosure, there arises the issue of whether the Commission should attempt to encourage issuers to provide investors with "better" information than is now mandated. In particular, the Commission should consider ways to further encourage the disclosure of so-called "soft information" or voluntary forward-looking information.

The value of forward-looking information to investors has been debated for the last 20 years. Until the early 1970s, issuers were prohibited from providing this information to investors because the Commission believed it was inherently speculative and created an opportunity for abuse. With the adoption of a safe harbor in 1979, the disclosure of forward-looking information was not only permitted, it was affirmatively encouraged. This safe harbor was intended to provide protection from liabilities under the Securities Act and the Exchange Act for companies that make projections in good faith and on a reasonable basis in

Commission filings. This was done because the Commission recognized that many investors and analysts found such information extremely useful in assessing the merits of investing in a particular company.

Over the years, issuers have provided this information orally to professional analysts and investors, either over the telephone or personally at so-called "road shows" (typically meetings hosted by issuers and underwriters with potential investors). By providing this information orally, issuers have avoided Securities Act Section 11 liability that attaches to a registration statement at the time of effectiveness. Further, it is believed that issuers are less likely to fear unfounded lawsuits by professional investors.

As a result, some believe that two separate (but parallel) disclosure systems have developed -- one for retail customers and one for professionals. The Commission itself recognized the existence of concerns in this area in connection with its Safe Harbor Concept Release. See Release No. 33-7101 (Oct. 13, 1994). In that release, the Commission sought comment on a panoply of issues relating to the disclosure of forward-looking information, including whether mandatory disclosure of projections in prospectuses was an appropriate solution to the problem of "road-show" selective disclosure.

Early in its inquiry, the Task Force evaluated concerns that have been raised with respect to this perceived disparity of disclosure, with a view toward recommending that the Commission consider requiring a fair summary in the front of the prospectus of any "road show" information (whether communicated orally or in writing). Based on the Commission's historic experience in this area, however, the Task Force was mindful that issuers likely would resist providing such disclosure absent assurances of some additional measure of protection. During the pendency of the Task Force, in December 1995, Congress enacted the Private Securities Litigation Reform Act creating a statutory safe harbor from liabilities from private rights of action arising from the disclosure of specified forward-looking information. As a result, it is uncertain at this early stage whether issuers will feel sufficient comfort to volunteer more forward-looking information in reliance upon the statutory safe harbor. It is important to note, moreover, that the new statutory safe harbor excludes, among other types of transactions, all initial public offerings. Accordingly, the Task Force suggests that the Commission's staff continue to monitor developments in this area.

### **C. TIMELY DELIVERY OF INFORMATION**

Regardless of how simple or how complete a prospectus is, it cannot aid an investment decision unless it is received prior to the time the decision is made. As discussed in greater detail in "Securities Act Concepts," however, questions

as to the appropriate timing and method of providing disclosure to investors are being widely debated. The Task Force believes that there is no quick fix in this complex area, and that the Commission should give full and careful consideration to these questions and the divergent solutions now being debated.

#### **D. ELECTRONIC MEDIA**

Discussions about the potential promises of electronic technology are not new. Even three decades ago, securities law experts were predicting that developments in communications technology would provide opportunities for improving disclosure, while at the same time reducing the cost of disseminating information to investors. In his 1966 article entitled "Truth in Securities Revisited," which contains proposals that contributed to the development of the integrated disclosure system, Professor Milton H. Cohen called the promises of technological development "the real hope and challenge" of securities regulation.

The potential promises in using electronic media as a disclosure medium are developing rapidly with respect to all types of information, including that relating to capital-raising activities and secondary trading in the securities markets. Technological developments are making it possible to deliver documents electronically, such as prospectuses that until recently were delivered in paper format. Just this past October, the Commission issued an interpretive release regarding the use of electronic media to deliver information under the Securities Act, the Exchange Act, and the Investment Company Act. See Release No. 33-7233 (October 6, 1995).

Meanwhile, access to most EDGAR documents has been commonplace for some time now for investors and the financial markets. And very recently, the Commission started its own "home page" on the Internet (World Wide Web address <http://www.sec.gov>), which contains Commission filings, rule proposals, litigation releases, opinions, speeches, testimony and press releases, as well as an electronic copy of this Report.

As is often the case, these positive developments are accompanied by some challenges of equal magnitude, some of which are unfolding with equivalent speed. Such disclosure challenges include establishing controls and procedures to ensure that information is presented in a clear, understandable format, that information is adequate and accurate, and that it is subject to the review of effective "gatekeepers." In addition, the Commission will likely be called upon to evaluate the effectiveness and efficiency of disseminating information through delivery, publication and/or access, and to respond to the ever-increasing pace of information flow. Indeed, the pace of information flow in some respects appears to have already begun to erode some of the assumptions traditionally made by

securities regulators, such as the existence of natural "information barriers." Some of these challenges, and possible responses to them, are discussed more fully in "Securities Act Concepts."

While resolution of these rapidly developing broad disclosure and legal questions in the electronic world is not within the scope or capability of the Task Force given the time-frame established for its work, the Task Force has included in this Report a few incremental recommendations designed to make the EDGAR system more user-friendly.

### **III. SECURITIES ACT CONCEPTS**

#### **A. STRAINS IN THE REGULATORY FRAMEWORK**

##### **1. Introduction**

In connection with the Task Force's review of existing rules, regulations and forms, questions have been raised with respect to several premises of, and concepts underlying, the Securities Act regulatory framework. Many of these questions currently are the subject of considerable debate, both within and outside the Commission. First instituted in the 1930s and revised over the years by Congress and the Commission, the intricate web of Securities Act provisions and rules governing the capital formation process have been criticized by some as excessively restrictive in light of present market conditions and, by others, as unduly lax in protecting investors. While none of the various participants in this debate seriously questions the fundamental importance of and need for full, fair and timely disclosure of information to investors, there is substantial disagreement as to how that goal best can be accomplished given the constant evolution of today's capital markets. A number of initiatives thus have been undertaken by the Commission, Congress, state regulators and the private sector, in an effort to reassess the continuing effectiveness of the Securities Act registration, prospectus delivery and other requirements.

Among these initiatives are the Commission's formation in early 1995 of the Advisory Committee on the Capital Formation and Regulatory Processes ("Advisory Committee"), which is chaired by Commissioner Wallman, and the Commission's publication for comment in mid-1995 of still-pending proposals to permit "testing the waters" in advance of an initial public offering (Release No. 33-7188 (June 27, 1995)); to re-consider the prohibition on general solicitation and advertising for private placements (Release No. 33-7185 (June 27, 1995)); and to craft appropriate rule revisions to keep pace with transfers of economic or other interests in securities through equity swaps, forwards and other

arrangements -- commonly known as "derivatives" -- without any accompanying transfer of legal title to the underlying "physical" instrument (Release No. 33-7187 (June 27, 1995); Release No. 33-7190 (June 27, 1995)). Other initiatives include legislation introduced by Congressman Fields (Capital Markets Deregulation and Liberalization Act of 1995. 104th Cong., 1st Sess. (1995)), and a blue-ribbon panel formed this past October by NASAA, of which Commissioner Wallman is a member.

The following discussion distills some of the ongoing debate regarding the need to adapt existing Securities Act requirements and related concepts to current market conditions, by outlining certain perceived strains in the system, the resultant problems for raising capital and timely dissemination of full and fair disclosure to investors, and a comprehensive solution and several narrow proposals that address certain of the perceived strains. The Task Force also is recommending a "quick fix" that, if adopted by the Commission, could resolve one issue without preempting the Commission's ability to evaluate the merits of any proposed broader initiatives. Recognizing therefore that these issues should be and are being fully and publicly deliberated in such diverse fora as the Advisory Committee, Commission rulemaking proceedings and the Congress, the Task Force believes that Commission implementation of the specific "quick fix" discussed below, as well as the concepts discussed under "Facilitating Capital-Raising," could serve to reduce unnecessary costs of corporate capital formation consistent with the disclosure objectives of the Securities Act.

## **2. Snapshot of the Securities Act Regulatory Scheme**

The Securities Act has served the U.S. financial markets well over the past 60-plus years. The volume of securities trading on the exchanges has doubled since 1935, increasing from \$176 billion to \$3.5 trillion. In 1934, businesses raised \$641 million in our capital markets; in 1984, \$126.8 billion; and last year, that figure broke a trillion dollars.

As adopted in 1933 and later amended by Congress, the Securities Act is intended to ensure that investors receive full and fair disclosure with respect to securities offerings by issuers and their affiliates. To this end, the Securities Act requires registration of every offer or sale of a security and delivery of a prescribed prospectus to investors unless the securities transaction complies with one of the enumerated statutory exemptions contained in Sections 3 and 4 of the Securities Act. In general, these exemptions reflect legislative judgments that certain types of investors or securities in certain types of offerings do not necessarily require the protections afforded by the Securities Act. One exemption of particular importance in the U.S. capital markets is the private offering exemption allowing issuers to offer and sell unregistered securities to financially sophisticated investors able to "fend for themselves."

In short, the statutory framework of the Securities Act provides that, absent an exemption:

- No security may be offered for sale until a registration statement containing prescribed information is filed with the Commission;
- After a registration statement is filed, oral and written offers are permitted. Written offers must be made by means of a statutory prospectus; use of sales literature or other writings are prohibited during this "waiting" period;
- After a registration statement becomes effective, either by lapse of time or more typically by Commission action, the confirmation of sale and other offering materials such as sales literature may be distributed to investors so long as the confirmation of sale and sales literature are accompanied or preceded by the final statutory prospectus; and
- After a registration statement becomes effective, securities may be delivered for sale so long as they are accompanied or preceded by the final statutory prospectus.

Moreover, securities sold other than pursuant to a public offering may be subject to strict limitations on resale, rules regarding how they can be offered and sold, etc.

In interpreting and administering the statutory scheme, the courts and Commission early on developed several Securities Act concepts, including:

- "general solicitation" -- broadly construed to mean identifying persons interested in acquiring securities in a private offering through advertisements or soliciting activities beyond persons having a pre-existing relationship with the issuer or placement agent;
- "gun jumping" or "conditioning the market" -- broadly construed to mean impermissible soliciting activities both prior to the filing of a registration statement and during the "waiting period" between such filing and the effective date; and
- "integration" -- generally the combination of either two or more ostensibly separate exempt offerings, or an exempt offering and registered offering, to assess compliance with the registration and prospectus delivery requirements of the claimed exempt offering.

Over the years, the Commission or its staff has modified these concepts to accommodate changes in the securities markets, including the rapid globalization

of those markets, the growth in institutional ownership of corporate equity and debt securities, the continuing development of new corporate financing techniques, and technological advances in communication. To illustrate, the Commission recognized early in its history that the integration concept might operate to impede unnecessarily legitimate capital raising transactions. Accordingly, the Commission in 1935 adopted Rule 152 providing for a limited exception from application of this concept to integrate legitimate private offerings with subsequent public offerings. Beginning with a 1986 interpretive letter (Verticom (avail. February 12, 1986)), the Commission staff has given issuers some comfort that an otherwise valid private placement would not be integrated with a subsequent public offering despite the fact that the public offering was contemplated at the time of the private placement. Previously, Rule 152 had been construed by many to mean that the public offering could not have been contemplated at the time of the prior private offering.

Further, the Commission has adopted safe harbors to guide issuers seeking to conduct legitimate unregistered offerings (Regulation D and Regulation S), and investors in reselling privately (Rule 144A), based on the fundamental principle that registration should be required only for those offerings made in the U.S. markets to persons who require the full panoply of safeguards afforded by the Securities Act. One such safe harbor created a "bright-line" integration test assuring companies that any offers or sales of securities they might make more than six months after completion of a private placement or other exempt offering under Regulation D would not be considered part of the previous offering. A later refinement of the integration concept was made in a staff no-action and interpretive letter (Black Box Inc. (avail. June 26, 1990)), which permits an otherwise valid private offering to a limited number of qualified buyers to be conducted concurrently with a registered public offering on the policy ground that such buyers possess the requisite level of sophistication to request the information they deem necessary to informed investment decision making through means other than a registration statement, and that investors in the registered offering are not adversely affected.

### **3. Specific Strains in the Regulatory Framework**

While the success of Commission and staff initiatives in this area is evidenced daily by the efficient operation of the public and private markets, strains in the current regulatory system are appearing in connection with various categories of securities offerings. In some cases, more and more people are asking whether the Securities Act's framework, at least as currently interpreted and administered, is working to frustrate, rather than to facilitate, the dissemination of information required, or in some instances demanded, by investors and other market participants. Five developments have been identified for the Task Force as eroding the Securities Act's effectiveness:

- Technological developments in the field of electronic communications;
- Erosion of traditional distinctions between public and private offerings;
- Globalization of the capital markets and concomitant erosion of "country walls" between such markets;
- Novel financing instruments, methods of raising capital and risk management initiatives; and
- Regulatory initiatives designed to reduce other market risks, such as those relating to the clearance and settlement system, which are compressing the time frame for many offerings.

The list is not intended to be all inclusive. Many other concerns have been raised. For example, delays in accessing the capital markets due to the need to file a registration statement for each offering may frustrate the issuer community. When issuers take advantage of the current shelf procedure, frustrations still may develop due to the need to register securities in advance, e.g., market overhang concerns. Moreover, distinctions and rules regulating "restricted securities" and securities sold offshore that flow back to the United States without any investor protections are also issues and concerns. The Advisory Committee has been studying and evaluating these and other strains and issues for the past year and the system it currently is reviewing intends to address these and other problems within the statutory framework while enhancing investor protection.

#### **a. Difficulties of Regulating Information Flow**

Regulatory requirements that result in the imposition of artificial barriers to the flow of accurate information generally are not effective, in some cases not possible, and are viewed by some as not ultimately in the best interests of investors and the markets. Whether for better or worse, market dynamics with respect to various securities transactions are starting to outstrip or have outstripped the current regulations. For example:

- Dramatic advances in electronic communications have made corporate communications, financial, business and marketing information, analyst research reports and other information more widely and instantaneously accessible through the Internet, Bloomberg's and other computer-based information service providers. As a consequence, in some offerings information outside of the mandated disclosure package -- the registration statement and the traditional prospectus that is part of the registration statement -- is readily available to and accessible by computer-literate investors acquiring securities in public offerings

and secondary trading transactions. Because of the Securities Act's broad coverage of offers as interpreted by the Commission, legal uncertainties exist as to whether dissemination of this information may give rise to impermissible offers.

- Information relating to the private securities markets, such as secondary price data and securities ratings, is accessible to sophisticated and unsophisticated investors alike. Similarly, information disseminated by a foreign company that is directed to persons outside the United States often is accessible to U.S. as well as foreign investors through the company's Website on the Internet, Bloomberg's, the press and other information service providers. Again, the Securities Act's broad coverage of offers as interpreted by the Commission raises legal uncertainties as to whether dissemination of this information may give rise to impermissible offers.

Compliance with required prospectus delivery obligations has become more and more difficult, and in some cases not possible. Questions frequently are raised about how to provide investors with disclosure that is received in sufficient time to be useful in making investment decisions. For example:

- Tensions have arisen between the prospectus delivery scheme of the Securities Act and private and public initiatives to minimize risk exposure by reducing clearance and settlement periods. Compliance with physical delivery of a final statutory prospectus before or concurrently with the confirmation of sale is becoming more and more difficult within today's "T+3" clearance and settlement period. This delivery problem likely will be exacerbated, unless more flexible means are used or permitted for communication, such as electronic delivery of information (see Release No. 33-7233 (Oct. 6, 1995)) and incorporation by reference if the financial markets generally were to move to a "T+1" clearance and settlement period, notwithstanding the Commission's recent adaptation of its prospectus delivery rules to accommodate T+3.

#### **b. What's Being Offered and Sold: Impact of Proliferation of Derivative Securities on the Regulatory Structure**

Today's regulatory structure focuses on offers, sales or transfers of legal title to a security evidencing a bundle of rights and obligations. However, securities transactions more and more frequently are premised on the concept of buying, selling or transferring financial, economic or investment risks and/or interests through swap agreements, forward contracts, options, option-like products and other derivative instruments. It is not unusual now for a company contemplating future sales of additional shares of stock to enter into "hedging" transactions for the purpose of minimizing its exposure to downward market price movements in its stock. The counterparty to the transaction, such as an investment banking firm, may manage its risk exposure by engaging in short selling activities in the

trading markets. (Generally speaking, short selling occurs when a person sells securities he or she does not own and subsequently settles the trade by either borrowing securities from another investor or buying the securities in the market.) Nor is it unusual for an investment banking firm bidding to underwrite an offering of new debt securities to hedge its exposure to movements in market rates of interest by entering into an interest swap agreement with a third party. Risk management activities effected through instruments that attempt to shift some or all of the economic risk to the public markets are becoming a regular way of doing business. While the Commission has sought through the rulemaking process to identify needed adjustments of existing rules to track economic risk-shifting and other unique or novel features of these transactions (e.g., Release No. 33-7250 (Dec. 28, 1995) (proposed Regulation S-K 305 relating to disclosure of derivatives); Release No. 33-7190 (June 27, 1995) (Regulation S release); Release No. 33-7187 (June 27, 1995) (proposed Rule 144 and Section 16(a) rule revisions)), much more must be learned before a comprehensive solution to these developments can be formulated.

### **c. Perceived Over-Regulation of Offers**

A further regulatory dilemma stems from applications of the gun-jumping and integration doctrines to prevent use of certain financing techniques in circumstances where investor protection concerns arguably are not implicated. Due to Commission interpretations, substantial legal uncertainties exist today with respect to the ability of a company to begin an offering of securities in reliance on the private offering exemption, and later switch to a registered public offering. Again due to Commission interpretation, substantial legal uncertainties regarding the validity of a private offering also exist when a company commences a public offering, withdraws its registration statement upon losing its market window, and makes a private placement of securities of the same class to financially sophisticated investors, unless it waits another six months. Despite the Black Box letter discussed above, companies remain reluctant to make limited private offerings to sophisticated buyers during a registered offering because of integration and general solicitation concerns. Legal and other commentators maintain that the uncertainties (and concomitant costs) surrounding an issuer's ability, based on current interpretation, to complete as registered an offering commenced privately, to conduct simultaneous private and public offerings, or to place privately securities with sophisticated buyers following a terminated public offering, unduly interfere with the capital formation process without providing countervailing investor protections.

### **d. Prospectus Delivery**

Another regulatory problem relates to the required method of delivering Securities Act prospectuses to investors. As discussed, the acceleration of the

offering process attendant to adoption of T+3 would be increased in the event the markets evolve further toward a T+1 environment. Even now as a result of often conflicting time pressures, the statutory prospectus may not be delivered until after the confirmation of sale.

#### **4. Advisory Committee on the Capital Formation and Regulatory Processes: Company Registration**

Following a one-year study, the Advisory Committee is in the process of completing its report to the Commission recommending a package of concepts termed "company registration." The purpose of company registration is to streamline and lower the costs of the capital formation process, improve investor protection and enhance corporate disclosure. In addition, the Advisory Committee intends that the company registration system, in full implementation, resolve all the various identified deficiencies in the current regulatory system for already public companies. At a public meeting held February 22, 1996, the Advisory Committee agreed upon the core elements of the company registration model, which would be implemented on an experimental basis pursuant to simple rule changes (described below) during a two-year, voluntary pilot project should the Commission adopt the Advisory Committee's recommendation. The Committee therefore directed its staff to complete a final draft of its Report and Recommendations for submission to the Commission, subject to additional revision in light of the last meeting's discussion and final review by the members.

As approved by the Advisory Committee, the company registration model to be presented to the Commission will recommend a shift in regulatory focus from the present, transaction-by-transaction registration of securities offerings by seasoned reporting companies, to the one-time, "pay-as-you-go" registration of such companies and all securities they (or their affiliates) might issue thereafter. Except for specified exceptions that the Advisory Committee believes the Commission should carve out solely for purposes of the pilot program, securities issued by a registered company would be deemed registered for both Securities Act and Exchange Act purposes, so long as the company continued to meet prescribed eligibility conditions (e.g., for purposes of the pilot, a two-year Commission reporting history, national stock exchange or Nasdaq/NMS listing, and \$75 million public float).

Company registration would have, among others, the following effects:

- permit disclosure to be incorporated by reference into a confirmation of a sale rather than require physical delivery of all information to a purchaser;
- allow identification of selling security holders in and underwriter(s) of a shelf offering at the time of the offering;

- allow a post-effective amendment to a shelf registration statement to include reallocation of previously registered securities and registration of new classes of securities;
- permit registration by certain issuers of a dollar amount without specification of the related classes of securities;
- eliminate staff review of all offering documents, except those involving "extraordinary" transactions (e.g., mergers of equals), and shift focus of staff review to periodic and current reports;
- permit registration fees to be paid at the time of a takedown from a shelf offering -- "pay as you go";
- narrow the class of persons considered affiliates of the issuer; and
- allow all acquisitions effected through an issuance of company stock, except those constituting "extraordinary" transactions (involving changes of more than 40 percent of a company's outstanding capitalization), to be made immediately off the shelf; as a consequence, all mergers, exchange offers, and other business combinations that fall below the 40 percent threshold can be made without a Securities Act waiting period -- having the effect of placing such mergers and exchange offers on the same time table as cash tender offers.

Along with focusing on the need to streamline the offering process to reduce the costs of corporate capital-raising, the Advisory Committee plans to recommend various disclosure enhancements that are designed to benefit investors in the context of securities offerings by issuers and affiliates, and the secondary trading markets. Specifically, use of the system would be conditioned upon the following enhancements: (1) additional reports to the board by senior management on compliance, on a continuous basis, with disclosure procedures established to ensure the integrity and accuracy of periodic and current reports and to avoid potential insider trading abuses; (2) inclusion of risk factors in Forms 10-K; (3) expansion and acceleration of reporting of material events on Form 8-K; and (4) certification by top managers, attached as exhibit to the Form 10-K, that they have reviewed all Exchange Act reports and are not aware of any materially false or misleading disclosures or omissions. Additional guidance would be provided regarding the due diligence responsibilities of such gatekeepers as underwriters, auditors and outside directors, with a view toward improving practices in this area.

Implementation of the two-year pilot company registration system, which as noted would be available on a voluntary basis only to seasoned companies,

would be accomplished pursuant to a series of rule amendments within the context of the current statutory framework. The necessary changes for the streamlining concepts, almost all of which are similar if not identical to the Task Force's recommendations for seasoned issuers outlined in "Facilitating Capital-Raising," would entail use of a new company registration form (Form C-1), modeled on current Form S-3 and the shelf registration procedure, with certain modifications. In addition to a "pay-as-you-go" fee regime, the system would include provisions for prior Commission staff review of offering documents filed in connection with "extraordinary" transactions (as previously described), and, significant to the Advisory Committee, extension of Section 11 strict liability to takedown prospectus supplements by requiring that they be filed on Form 8-K no later than the sale of securities. There would be no change in the nature or amount of disclosure required to be on file with the Commission at the time of the sale of securities -- all current line-item disclosure requirements would carry over to the pilot.

## **5. Other Suggestions**

The Advisory Committee has labored to devise a comprehensive and detailed model to lower the costs of the capital formation process, improve investor protection and enhance corporate disclosure. The model seeks to address all of the perceived strains on the system for already public companies. Several other ideas have been floated to address certain of the perceived strains described above.

### **a. Regulating the Flow of Information**

One approach is set forth in a speech delivered by Linda C. Quinn, former Director of the Commission's Division of Corporation Finance to the fall meeting of the American Bar Associations' Federal Regulation of Securities Committee in Washington, D. C. (Linda C. Quinn, Reforming the Securities Act of 1933: A Conceptual Framework. 10 Insights 25 (Jan. 1996)). This approach suggests that offers be deregulated and the mandate that the statutory prospectus be the only written communication during the offering period be reconsidered. The speech posits whether the federal securities laws might better serve investors by assuring the free flow of fair and accurate communications, whether written or oral, rather than by restricting the content and manner of any communications. Distinctions between oral and written communications would be removed.

In addition to the manner in which information is communicated to investors, the speech also suggests that the traditional single uniform approach to delivery of the mandated prospectus may no longer be warranted. Rather, it is suggested that the costs of delivering a mandated document be balanced against the benefits provided to investors.

Another suggestion being floated that relates to deregulating offers and revisiting the mandated delivery system would be to provide information about the issuer and its securities through a core information file available at the Commission. The content of this file has not yet been fleshed out. Under this idea, strict liability under Section 11, now applicable to false and misleading registration statements, would attach to the core information file. While written or oral offers of securities could be made without the necessity of compliance with the statutory prospectus requirement (in the case of the written offers), no sales could be effected until the company's core data base file is current and complete. Negligence liability under Section 12(2) would apply to all material outside the core file. Because information in the core file would be publicly available and accessible by any investor, the requirement to deliver the information (today through the statutory prospectus) prior to or along with the confirmation of sale would be eliminated. The description provided to the Task Force did not distinguish between seasoned and unseasoned issuers.

#### **b. "Pink Herring" Registration of Offers**

A countervailing approach intending to maintain the investor protection benefits in the Securities Act, to the deregulating offers concept just described, would permit offers to be made after an issuer filed a highly simplified, short form and inexpensive registration statement (termed by some a "pink herring"). Thereafter, the company could elect whether to pursue a public or a private offering in light of the type and level of investment interest thus elicited. Far broader in scope than the pending "IPO test the waters" proposal (see Release No. 33-7188 (June 27, 1995)) because it would permit general soliciting communications that are clearly "offers" subject to Securities Act registration, and permit non-registered sales to be made on the basis of registered offers, this approach is premised on a similar concern for reducing unnecessary financing costs.

Private or already public companies could "test the waters" without risking a violation of the statute by filing the "pink herring" containing limited price, type of security, distribution and financial information. They then would be permitted to make a general solicitation and public offer and obtain a preliminary assessment whether enough market interest exists to warrant the expense of a fully registered public offering. Regardless of the amount of securities intended to be offered, the initial filing fee would be nominal, such as \$250. If investor interest in registered securities were deemed sufficient to justify the costs, the issuer subsequently could pursue a fully registered public offering (distribution of a traditional red herring and final prospectus subject to the full panoply of Securities Act liabilities, and payment of the full registration fee). If instead, the issuer determines that it can sell only privately, to financially sophisticated investors pursuant to a private offering, it could proceed in that direction without

waiting six months between the public, or "registered," offers and a subsequent private placement. A new safe harbor would prevent integration of the registered offers and non-registered sales, subject to speckled conditions. Concerns about protecting the retail investing public should not be implicated if only qualified, non-retail investors would be allowed to purchase the privately placed securities (alternatively, placement could be permitted under any other applicable exemption without regard to any general solicitation limitation).

## **6. Quick and Narrow Fixes -- Task Force Recommendations**

In addition to the specific suggestions described below, the Task Force also outlines other more general ideas in Subpart 7 that follows.

### **a. Revise Rule 152**

The safe harbor of Rule 152 is limited to a private offering conducted in reliance on the Section 4(2) private placement exemption (this would include the limited offering exemption of Rule 506 of Regulation D) that is followed by a public offering (whether conducted pursuant to the registration process or one of the public offering exemptions).

The Task Force recommends that the Commission revisit the current safe harbor with a view towards expanding its reach so as to permit a company to switch from a private to public offering without the necessity for an intervening termination of the private offering. In addition to removing artificial barriers that do not further the disclosure purposes of the Securities Act, liberalization of Rule 152 also will permit a company to engage in "test the waters" offering activities among qualified investors in reliance on the private offering exemption prior to filing a registration statement.

In addition to the above suggestion, the Task Force concurs with commentators that a comparable safe harbor should be implemented with respect to exempt small business offerings conducted in reliance on Section 3(b) of the Securities Act that are followed by a public registered offering. The safe harbor would provide only that an otherwise valid exempt offering need not be integrated with either a subsequent public offering or an earlier abandoned public offering. In considering this suggestion, the Commission should consider whether or not the safe harbor should permit companies to start an offering as an exempt public offering and complete it as a registered offering. In other words whether the safe harbor should allow for unfettered "test the waters" offering activities prior to filing of the registration statement.

The Task Force believes that the Commission should consider whether certain offerings that may give rise to disclosure abuses should be excluded from any of

these safe harbor suggestions. Historically, such offerings have included blind pools, blank check companies, penny stocks and direct participation investment programs.

## **b. Presumptive "Public Offering" Doctrine**

Since 1984, it generally has been the staff's position that the act of filing with the Commission a registration statement in connection with a non-shelf offering is deemed to be the commencement of the public offering of securities covered by that registration statement. Consequently, a company is viewed as engaging in soliciting activity whether or not the company or other participants in the distribution in fact use the document to market securities. As a result, companies that for valid reasons determine after making their filing with the Commission that a public offering is not feasible generally are precluded from raising capital in the private markets until the registration statement is withdrawn and the six-month safe harbor from integration that is set forth in Regulation D is satisfied.

In the Task Force's view, a publicly filed registration statement should not result in a per se conclusion that the company is engaging in general soliciting activities. Rather than rely on an irrebuttable presumption, the Task Force suggests that the traditional facts and circumstances general solicitation analysis used in other contexts also be applied here. To provide greater certainty to companies, however, the Task Force recommends that the Commission consider adopting a safe harbor that would allow a company to access the private markets while it has "quietly" filed a registration statement with the Commission.

In formulating a safe harbor, the Task Force suggests that the Commission consider the inclusion of investor protection safeguards relating to investor sophistication and the nature of the offering (e.g., has the type of offering raised investor protection concerns in the past). Further, the structure of the safe harbor will depend in part on the Commission's regulatory response to general soliciting activities.

## **7. Pending Staff Initiatives**

### **a. Prospectus Delivery**

The Commission last May adopted revisions to its rules and forms and a new rule to implement two solutions to prospectus delivery issues arising in connection with the change to a T+3 clearance and settlement period (Release No. 33-7168 (May 11, 1995)). The Task Force understands that last fall the Commission staff informally was advised of other prospectus delivery issues and currently is working to address the problem. The Task Force further understands that this initiative is intended to address a specific identifiable problem and will

not attempt to resolve the more global concern of how and when information should be provided to investors.

Regardless of the outcome of this initiative, the Task Force recommends that the Commission consider whether there may be certain types of offerings where delivery of the mandated disclosure document prior to or with the confirm does not further the information flow to investors. For instance, when a seasoned issuer is offering additional shares of common stock, the Commission should consider permitting full incorporation by reference into a confirmation sent to an investor; an approach also contemplated by the Advisory Committee's company registration model. Such an approach could be based on the nature of the purchasers and/or the offering.

#### **b. Offshore Press and Internet Activities**

Concerns have been expressed that journalists for publications with circulation in the U.S. have been excluded from offshore press activities conducted by foreign issuers. Preliminary Note 7 to Regulation S states that such journalists should not be precluded from offshore press conferences, press releases and meetings with company press spokespersons in which an offshore offering or tender offer is discussed, provided that the information is made available to the foreign and U.S. press generally and is not intended to induce purchases or tenders of securities by U.S. persons. Nonetheless, foreign issuers involved in global offerings with a public or private U.S. tranche have been concerned that U.S. press contacts would constitute "gun jumping" and thus improper offers under the Securities Act. The Task Force understands that the Commission staff currently is working on a proposal to address these concerns.

Similar uncertainties arise when a foreign issuer involved in an offshore offering puts information about the offering up on its Internet Website that is accessible by U.S. persons. Even though the offer is not being made to U.S. persons, concerns have been raised that this activity might constitute an improper offer under the Securities Act. The Task Force understands that the Commission staff currently is working on a proposal to address these concerns.

### **IV. FACILITATING CAPITAL-RAISING**

The Task Force recommendations described below are intended to streamline further procedures and practices under the current registration system. The recommendations for seasoned issuers set forth under the "Shelf Offerings" caption, as well as certain other items in this Report, are substantially identical to the streamlining concepts of the "company registration" framework developed by

the Advisory Committee. Although the Task Force was not designed to overlap with the work of the Advisory Committee, the Task Force members have followed the work of the Advisory Committee. The Task Force recommends almost all of the streamlining elements of company registration. Given its original purpose, the Task Force only has sought to identify and recommend ways to streamline the regulatory process and thus only has looked at the suggestions individually. Were the Commission to reach the next step of putting the pieces together into a comprehensive package, the Task Force recommends that the Commission consider reasonably expected investor protections consequences of any particular package. The Task Force notes that the Advisory Committee has devoted significant time to deliberations on these issues as it assembled its complete model and has added, what the Advisory Committee intends to be, significant investor protections.

The Task Force anticipates that concerns likely will be raised regarding the effect the recommendations may have on the disclosure documents used by seasoned as well as smaller issuers. Some concerns already have been expressed regarding increased reliance on Exchange Act reports of smaller issuers. For instance, underwriters may have reservations regarding the increased use of annual and quarterly reports to replace the type of prospectus disclosure which formerly reflected substantial investigation and input from underwriters and counsel. With respect to seasoned issuers, underwriters and other persons having a due diligence obligation under the Securities Act may have reservations that the recommendations will frustrate further their ability to conduct such investigations by compressing further the time period between when an issuer decides to access the market and its securities are sold (sometimes no more than a couple of hours).

The Task Force has decided that on balance, even though concerns have been and likely will be raised on some or all of the recommendations, it made better sense to include the recommendations in the Report. In the Task Force's view, the concerns should not be insurmountable and thus can be addressed in connection with any rulemaking initiatives the Commission undertakes.

The Task Force believes that the Commission, in its consideration of these recommendations and any alternatives that may be suggested, should take steps to ensure that the quality of disclosure provided to investors be at least of the same quality as that provided to investors today. The Task Force notes that improving the quality of disclosures in periodic reports is an area being considered by the Advisory Committee.

## **A. DELIVERY OF EXCHANGE ACT PERIODIC REPORTS**

**Eliminate Forms S-2/F-2, and permit smaller companies reporting on Forms S-1/F-1, and timely reporting for 12 months, to deliver along with their prospectuses periodic reports in lieu of restating information regarding themselves in prospectuses.**

Companies that have been filing Exchange Act reports with the Commission ("reporting companies") for a three-year period and meet the other registrant criteria are eligible to register their securities offerings on Forms S-2/F-2. Under this framework, rather than reiterating in the prospectus the company-specific information found in their Exchange Act reports, companies may incorporate by reference that information into the prospectus and physically deliver annual and interim reports with a prospectus more focused on the details of the offering. The Task Force believes that the benefits of this delivery option should be extended to a larger group of issuers and recommends that the three-year reporting requirement be reduced to one year. Because of the substantive disclosure included in today's proxy statement, the Task Force also recommends that the Commission consider expanding the information package that can be delivered to include the proxy statement.

This recommendation should reduce the costs of registration for approximately 4,800 smaller companies by eliminating certain printing and other costs associated with the preparation of a traditional prospectus filed as part of a registration statement on Forms S-1/F-1. According to statistics compiled pursuant to the Paperwork Reduction Act of 1980, preparation time of Forms S-2/F-2 is less than half the preparation time of Forms S-1/F-1. Additionally, the terms of the offering, including the securities to be offered, and the risks and benefits of investment would be highlighted since the prospectus would not restate information about the company. For company-specific information, shareholders need only look to the annual and interim information delivered with the prospectus. Of course, any material changes in the registrant's affairs since the end of the latest Form 10-K which were not described in subsequent Forms 10-Q would have to be discussed in the prospectus filed as part of the effective registration statement or, during the post-effective period, in a prospectus supplement.

This recommendation, which narrows significantly the gap between Forms S-1/F-1 and Forms S-2/F-2, would obviate the need for those two separate and distinct registration forms. The Task Force thus recommends that Items 11 and 12 of Forms S-1/F-1 -- which relate to the information about the company -- be modified to include the voluntary delivery option for companies which have been reporting for at least one year, so that such companies have a choice of including comprehensive disclosure within the prospectus or delivering information. Forms S-2 and F-2 then could be eliminated, a result consistent with suggestions

received by the Task Force and with the streamlining recommendations contained elsewhere in this Report.

The advantage of delivering Exchange Act documents with the prospectus (instead of physically putting company-related information in the prospectus) also would extend to use of Form S-4 and Schedule 14A. For exchange offers and merger proxy solicitations on that form and schedule conducted by (and for) 12-month Form S-1/F-1 registrants, use of the delivery option could mean even more savings for smaller companies.

Where a company distributes required documents to its shareholders, the Commission may want to consider the appropriateness of allowing existing shareholders to elect not to receive additional copies of the same information in connection with the company's offering of additional securities. The Task Force believes that the option not to receive documents should rest with the shareholders.

The Task Force recognizes that this recommendation may be inconsistent with its recommendations designed to improve the readability of disclosure documents. While implementation of this recommendation may result in registration statements that are more focused on the proposed offering, the delivery of multiple documents (e.g., the prospectus, annual report, and quarterly reports) could create a less readable and user friendly presentation than a single comprehensive prospectus. One way to address readability concerns in these circumstances is to require a one-page guide, or "road map," which would essentially be a more descriptive table of contents. In any event, if this recommendation is implemented, the Commission should monitor disclosure practices to assure that the disclosure package provided to investors is readable and informative.

The Task Force also anticipates that concerns might be expressed regarding the quality of the disclosure in the Exchange Act reports of less-seasoned issuers. Some concerns have been expressed regarding increased reliance on Exchange Act reports of smaller issuers. Underwriters may have reservations regarding the increased use of annual and quarterly reports to replace the type of prospectus disclosure which today often provides the opportunity for substantial investigation and input from underwriters and counsel. To address such concerns the Commission, in its consideration of the expanded delivery option, should take steps to ensure that the quality of disclosure provided to investors in the offering documents be at least of the same quality as that provided to investors in today's traditional prospectus. The Task Force notes that the quality of disclosure in periodic reports and the adequacy of due diligence on such reports by underwriters and directors are areas being considered by the Advisory

Committee.

## **B. SHELF OFFERINGS**

The Task Force recommends several revisions to the shelf registration procedure so as to provide increased flexibility to a wider array of companies with respect to their capital-raising activities. Among other things, these recommendations include: permitting delayed pricing for registrants that have been reporting for 12 months; eliminating restrictions on "at-the-market offerings" by seasoned Form S-3/F-3 eligible companies; permitting a modified universal registrant procedure; and permitting short form universal shelf registration statements to include secondary resales.

### **1. Smaller Issuers**

**Allow smaller companies to price the securities on a delayed basis in order to time securities offerings more effectively with opportunities in the marketplace.**

Today, smaller companies may not be able to take advantage of "market windows" for their securities because they are not eligible to use the Commission's shelf registration process for primary delayed offerings. The Task Force believes that the Commission should consider providing a modified form of shelf registration procedure to smaller companies.

The Task Force suggests that a procedure similar to Rule 430A, but without the requirement that a prospectus supplement containing pricing information be filed within 15 business days after the effective date of a registration statement, be provided to 12-month reporting companies. No changes to either the short form registration eligibility requirements or disclosure requirements are suggested. In short, the prospectus would be complete except with respect to pricing information permitted to be omitted under Rule 430A. However, given that disclosure of certain terms of preferred or debt securities, such as financial covenants, may not be practicable until pricing, the Commission should consider whether some additional flexibility with respect to delayed disclosure is appropriate for such securities. The Task Force contemplates that, like today under Rule 430A, the pricing-related information contained in the pricing supplement would be deemed part of the registration statement, and accordingly this recommendation would not change the protections afforded investors under the liability provisions of the Securities Act.

As a result of this recommendation, approximately 4,800 smaller companies would be able to sell their securities on a delayed and continuous basis, as long

as they deliver a pricing supplement containing Rule 430A information, their base prospectus and any updating prospectus supplements. It has been suggested that providing additional flexibility to smaller companies could result in such entities raising more capital through the public markets rather than through exempt offerings conducted in the domestic and offshore markets.

While this recommendation will afford small companies time and cost savings, the Task Force appreciates concerns raised about possible adverse effects shelf registration may have on the adequacy and accuracy of disclosures provided to investors, on Commission oversight of the disclosures and on the role of underwriters in the registration process. These concerns are similar to those raised when the shelf registration rule was first being considered on a temporary basis and was made available to any offering including an initial public offering. One suggestion to address these concerns is to require a waiting period between the company's determination to sell its securities and the commencement of the offering, during which an underwriter could conduct a due diligence examination. Further, certain types of offerings may give rise to disclosure abuses. Such offerings historically have included blind pools, blank check companies, penny stocks, and direct participation investment programs. In formulating a modified shelf rule for smaller issuers using Form S-1, the Commission therefore should consider excluding, in whole or in part, such offerings from the procedure.

Moreover, the Task Force anticipates that the registration statement and any post-effective amendment to reflect a fundamental change or to update the financial statements and other information in accordance with Section 10(a)(3) of the Securities Act, as well as the company's periodic reports filed under the Exchange Act, would remain subject to Commission oversight through the selective review process.

## **2. Seasoned Issuers**

### **a. Reconsider restrictions on "at-the-market" shelf offerings registered by seasoned issuers on Forms S-3/F-3.**

An "at-the-market offering" is an offering on a national securities exchange or through a market maker of securities for which there is an existing trading market. For example, if a company's common stock is trading on the New York Stock Exchange and that company offers shares of common stock on or through the facilities of an exchange or to or through a market-maker otherwise than on an exchange at the then current market price, it is conducting an at-the-market offering. The Task Force suggests that the Commission reconsider the feasibility, consistent with investor protection and orderly market concerns, of eliminating one or more of the current restrictions on an at-the-market shelf offering to make

it a more useful tool for capital-raising by seasoned issuers eligible to use Forms S-3/F-3 for offerings of common stock and non-investment grade securities.

Under current rules, a registrant may not make an at-the-market offering on Forms S-3/F-3 unless certain conditions are met. The conditions are that: the amount of securities registered cannot exceed ten percent of the registrant's non-affiliate public float (i.e., the aggregate market value of the registrant's outstanding voting stock held by non-affiliates of the registrant); the securities must be sold through an underwriter or underwriters acting as principal(s) or agent(s) for the registrant; and the underwriter or underwriters must be named in the prospectus.

Concerns have been raised as to whether elimination of any or all of the at-the-market offering requirements may have the unintended effect of impairing investor protection and contributing to disorderly markets. These concerns are similar to concerns raised when at-the-market offerings were initially considered by the Commission at the time that it adopted procedures for primary shelf registration. The Task Force therefore believes that further analysis of the use of at-the-market offerings, and reconsideration of the original concerns prompting inclusion of the restrictions on their use, particularly in light of subsequent regulatory changes, is warranted. This review should take into account the Commission's overall experience with the shelf registration process and subsequent regulatory changes, including the proposal of the Task Force to amend the trading practices rules.

**b. Permit companies engaging in shelf offerings to include secondary offerings without identifying the selling security holders until the time of the actual offering.**

In 1992, the Commission adopted provisions permitting universal shelf offerings in an effort to facilitate the use of shelf registration for delayed offerings of common stock and convertible securities. Universal shelf provisions permit registration of a dollar amount of securities without identifying the precise timing of each subsequent offering or specific amount of each class to be offered, provided the aggregate dollar amount of the securities to be offered is set forth in the registration statement. For example, a company can register an aggregate dollar amount, identify the classes of securities covered and not allocate the specific amounts to be offered in each category. At the time of its adoption, the Commission only contemplated use of the universal shelf for primary offerings of securities. The Task Force does not believe that there is a need to retain that restriction and recommends that the Commission consider expansion of the universal shelf provisions to permit registration of secondary offerings. Under this proposal, issuers would not be required to identify the selling security holders

until the time of the actual offering unless such identities are known prior to the date that the initial registration statement is declared effective.

**c. Adopt a "universal registrant" rule, which would enable a parent company to name itself and its majority-owned subsidiaries as possible issuers on a shelf registration statement, and defer the choice of actual issuer until the time of takedown.**

In some instances, an issuer is not in a position to determine whether it or one of its subsidiaries will be issuing securities included on a shelf registration statement. The Commission staff has taken a no-action position where a registrant named itself as well as its wholly-owned finance subsidiaries in a registration statement as possible issuers, so that the actual "issuer" could be chosen later at the time of the takedown.

The Task Force recommends that the Commission consider the need for a rule that would more broadly permit an issuer to name on a registration statement itself and one or more of its majority-owned subsidiaries as possible issuers. This modification would eliminate pressure on multiple registrants to select prematurely the registrant, whether or not a finance or operating entity, which will be implementing the takedown from the shelf without reducing the level of significant information provided to investors. Each registrant, however, would have to meet independently the form eligibility requirements. Further, the financial and narrative disclosures in the registration statement would have to be complete with respect to each of the named registrants. Depending on the structure of the offering, a separate core registration statement may be required for each registrant. In addition, care should be taken to avoid the potential for investor confusion with respect to the issuer of the securities.

**d. Permit a company to reallocate securities, or register a new class of securities, on a shelf registration statement by post-effective amendment.**

Rule 413 requires that a registrant file a new registration statement in order to supplement its offering with additional securities. However, the Task Force believes that the Commission should consider whether Rule 413 should be construed to preclude an issuer from either adding an additional class of securities or reallocating the securities registered on its registration statement by way of post-effective amendment. To address possible disclosure abuses, the Commission may decide to require such post-effective amendments to be declared effective and not receive the same administrative treatment as post-effective amendments filed pursuant to Rule 462(b). Post-effective amendments filed pursuant to Rule 462(b) to increase the size of an offering by no more than 20 percent become effective automatically upon filing with the Commission.

For example, a registrant originally registers one million dollars consisting of 100,000 shares of common stock priced at \$5.00 per share and 100,000 shares of preferred stock also priced at \$5.00 per share. If some time after the registration statement is declared effective, the registrant decides to reallocate its one million dollar offering to include 50,000 shares of common stock and 150,000 shares of preferred stock, the registrant could do so by way of a post-effective amendment so long as the one million dollar offering amount is not exceeded. Similarly, a company that has an effective one million dollar universal shelf registration statement covering senior securities may add common stock by means of a post-effective amendment so long as the one million dollar offering amount is not exceeded. If the one million dollar offering amount is exceeded under either example, the excess amount must be registered on a new registration statement, unless the recommendation described below to permit registration of additional dollar amounts by post-effective amendment is implemented by the Commission. Depending on the structure of the offering, this may require a separate core registration statement for each registrant.

**e. Permit seasoned issuers to register a dollar amount without specifying the classes of securities being registered.**

Under current Commission rules, seasoned issuers are permitted to register dollar amounts of securities provided that they identify the classes of securities covered by the registration statement for all securities they reasonably expect to issue over the ensuing two years. Since such issuers may not determine the specific terms of the securities until the actual offering date, disclosure regarding the classes of securities being registered is often general since most of the terms typically are not known at the effective date.

The Task Force recommends that the Commission consider the feasibility of allowing such seasoned issuers to register dollar amounts without specifying the classes of securities registered. Disclosure regarding the exact class and terms of securities to be offered would be provided at the time of the offering. As a result, such issuers would be afforded even greater flexibility in their capital-raising efforts than under the current regulations.

Furthermore, the Task Force recommends that such issuers be permitted to register additional dollar amounts by means of post-effective amendments rather than the current procedure of filing a new registration statement and using Rule 429 to bring up currently effective registration statements into the new registration statement. The Commission should consider whether this is consistent with Section 6(a) of the Securities Act.

**f. Allow seasoned issuers to pay registration fees at the time securities are taken down from the shelf.**

Although seasoned issuers may conduct delayed offerings by taking advantage of the shelf registration procedure, they are required to pay fees to the Commission upon the initial filing of the registration statement. As a result, issuers may be paying fees to the Commission months before they are actually offering securities to the public.

The Task Force suggests that the Commission consider its authority to implement a "pay as you go" policy pursuant to which seasoned issuers would be permitted to pay fees at the time securities are taken down from the shelf. This would provide issuers with additional flexibility by allowing them the use of the funds required for Commission fees until the actual offering date.

### **C. FUNDAMENTAL CHANGES**

**Consider clarifying what is a "fundamental change" to provide registrants with certainty regarding when a post-effective amendment is required.**

The Task Force suggests that the Commission provide greater certainty with respect to what events constitute a "fundamental change" requiring a registrant to file a post-effective amendment to its shelf registration statement. The Task Force recommends that the Commission set forth specific situations which would be considered a fundamental change requiring a post-effective amendment, including a change in accountants, a change in control, a change that cannot be succinctly stated in a supplement, a material acquisition or disposition, a change in the business or operations of a registrant that would require a restatement of the financial statements, or bankruptcy.

The undertaking to file a post-effective amendment to reflect a fundamental change applies to continuous and delayed offerings permitted under the Commission's shelf registration rule, Rule 415. The Task Force suggests that the Commission consider requiring a post-effective amendment filing for any offering, whether or not it relates to an offering conducted under the shelf registration rule, whenever there is a fundamental change.

### **D. BROKER-DEALER RESEARCH REPORTS**

**Consider streamlining and modernizing the safe harbors provided in Securities Act Rules 137, 138 and 139 relating to the use of broker-dealer research reports.**

Securities Act Rules 137 through 139 provide safe harbors for brokers and dealers who disseminate information, opinions or recommendations regarding registrants or a class of a registrant's securities. The Task Force recommends that the Commission, consistent with investor protection, consider ways to streamline and modernize those rules to, among other things, reflect rapid advances in communications technology, globalization of the markets and other developments since these safe harbors were adopted in 1970; For example, the Commission may wish to consider whether the current exclusion from these rules of any research report with respect to initial public offerings remains necessary for and consistent with investor protection. The Task Force also recommends that Rule 138, which is a narrow rule relating to research reports concerning S-2/F-2 companies, be consolidated with Rule 139.

While revisiting these rules, the Commission also should review certain restrictions on participating dealers publishing reports regarding companies ineligible to use Forms S-3/F-3, such as the prohibition against publishing a more favorable opinion or recommendation than that published in their last publication. Specifically, the Commission should consider whether these restrictions should be based upon criteria other than the form eligibility of the issuer, such as market capitalization.

## **E. MARKET-MAKING TRANSACTIONS**

### **Eliminate an affiliated broker-dealer's prospectus delivery obligation in connection with "regular way" market making transactions.**

Market-making transactions by a broker-dealer who is an affiliate of the issuer of the securities in which the broker-dealer makes a market must comply with the registration and prospectus delivery requirements of the Securities Act. The Task Force recommends that the Commission eliminate the affiliated broker-dealer's prospectus delivery obligation that exists for "regular way" market-making transactions in outstanding securities of a Section 12 reporting company. The Task Force believes that under these circumstances, the burden on dealers can be reduced without sacrificing investor protections. In implementing this recommendation, the Commission should consider whether certain offerings that traditionally have given rise to abuses should be excluded. Historically, such offerings have included blind pools, blank check companies, penny stocks and direct participation investment programs.

## **F. AFFILIATE STATUS**

**Consider revising Rule 144's definition of "affiliate," consistent with Section 2(11) of the Securities Act, to exclude certain persons, such as some outside directors, who are not actually or potentially in a position to control a company's offering activities.**

The Task Force recommends that the Commission consider whether the broad concept of "affiliate" could be narrowed to focus, consistent with Section 2(11), on persons in a position actually or potentially to control the issuer's activities. Some critics maintain that the concept has expanded unduly over the years to cover all Section 16 insiders, regardless of actual or potential control. The Commission may want to consider this proposal in conjunction with its consideration of the scope of "outside directors" for proportionate liability allocation purposes under the Private Securities Litigation Reform Act of 1995.

Under Rule 144(a)(1) an "affiliate" of an issuer includes "a person that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, such issuer." The Task Force believes that a broad rule subjecting secondary resales to the provisions of Rule 144, solely because of a person's status as an outside director, may not further the purposes of the Securities Act. Individual outside directors usually are not conduits for distributions by the issuer unless they are associated with a broker-dealer. This recommendation would not alter any other obligation of outside directors to comply with other applicable provisions of the federal securities laws, including the obligation to report holdings and transactions on Forms 3, 4 and 5 pursuant to Section 16(a) of the Exchange Act.

## **G. TRUST INDENTURE ACT OF 1939**

The Task Force understands that the Commission may undertake a study of the Trust Indenture Act of 1939 (the "Trust Indenture Act") to evaluate the continued effectiveness of specific provisions of the Trust Indenture Act, and to determine whether the outright repeal or fundamental revision of the Trust Indenture Act advocated by some commentators would be appropriate. If the Commission undertakes such a study and determines that the Trust Indenture Act should be maintained, the Task Force recommends the following revisions in order to further streamline the rules promulgated under the Trust Indenture Act.

**1. Permit a shelf registrant to qualify an indenture by post-effective amendment so that it need not file a new registration statement when adding a new class of debt securities.**

Under Section 309(a)(1) of the Trust Indenture Act, indentures relating to registered debt securities are deemed to be qualified upon effectiveness of the

registration statement. Currently, there are no provisions for the post-effective qualification of indentures under the Trust Indenture Act. However, indentures used in delayed offerings, while qualified at the time of effectiveness, frequently do not specify business terms until the actual sale of the securities at a date later than the effectiveness of the registration statement. Under current practice, a form of indenture is qualified at the time the registration statement goes effective, with the business terms permitted to be specified in a supplemental indenture.

When a registrant wishes to reallocate securities in a shelf registration statement to issue debt securities that were not included in the registration statement at the time of effectiveness, however, the registrant currently would be required to file a new registration statement in order to both reallocate the securities and to qualify a new indenture. In another proposal, the Task Force recommends permitting registrants to reallocate securities registered on shelf registration statements by post-effective amendment. As a follow-up to the reallocation proposal, the Task Force further recommends allowing for post-effective qualification of indentures. As a result, registrants would be able to reallocate debt securities on a shelf registration statement by post-effective amendment. This proposal would provide issuers with complete flexibility in reallocating registered securities.

In order to allow for post-effective qualification of indentures, the Task Force recommends that the Commission promulgate a rule under the Trust Indenture Act that defines when "registration becomes effective as to such security" under Section 309(a)(1) for purposes of securities to be offered on a delayed basis. Under the definitional rule, a registration statement would become effective as to securities to be offered on a delayed basis either: (i) when the registration statement becomes effective; or (ii) when a post-effective amendment containing the new form of indenture becomes effective. As with the current system, this system could involve the qualification of the new form of indenture contained in the post-effective amendment, with the business terms specified later in a supplemental indenture.

The Task Force believes that allowing for post-effective qualification would not erode investor protection since the indenture still would be qualified prior to any sales of securities and all the mandatory indenture provisions under the Trust Indenture Act would be automatically incorporated into the qualified indenture as required by the 1990 amendments to the Trust Indenture Act.

## **2. Eliminate Forms T-1 and T-2 for determining trustee eligibility and, instead, require an issuer to make an "eligible trustee" representation in the registration statement.**

Under Section 305(a) of the Trust Indenture Act, the Commission may require that certain information regarding the trustee be disclosed by the registrant in its

registration statement so that the Commission can determine whether the trustee is eligible to act under Section 310(a). Such information regarding trustee eligibility must be contained in a separate part of the registration statement and signed by the designated trustee. Currently, the Commission requires registrants to use Forms T-1 (for a corporate trustee) and T-2 (for an individual trustee) for statements of eligibility and to file the forms as exhibits to the registration statement. In 1994, 962 Form T-1s were filed and zero Form T-2s were filed and, in 1995, 683 Form T-1s were filed and zero Form T-2s were filed.

The 1990 amendments to the Trust Indenture Act substantially reduced the disclosure requirements under Forms T-1 and T-2. Specifically, the trustee eligibility provisions were amended so that the enumerated conflicts of interest are disqualifying, and must be disclosed, only if there is a default. Therefore, under the post-1990 Form T-1, if no default exists, the registrant need only provide information required by Items 1, 2, 15 and 16 of the form concerning the name of the trustee, any affiliations of the trustee with the obligor, the order or rule by which a foreign trustee is authorized to act as sole trustee, and certain exhibits relating to trustee eligibility. Similarly, under Form T-2, the registrant need only disclose a limited amount of information (Items 1 and 2) if no default exists. However, other than the exhibits, much of the information required under Forms T-1 and T-2 where there is no default is already required to be disclosed in Securities Act registration statements as part of the description of securities. Item 202(b)(10) of Regulation S-K requires the registrant to disclose, in part, the "name of the trustee(s) and the nature of any material relationship with the registrant or with any of its affiliates."

The Task Force recommends that Forms T-1 and T-2 be eliminated. In lieu of filing a statement of trustee eligibility on Form T-1 or T-2, the Task Force recommends that the registrant be required to make a representation in the registration statement that the named trustee is eligible to act under Section 310(a). The representation would serve as part of the information used by the Commission in determining trustee eligibility rather than the information provided on Forms T-1 and T-2. Because of the Commission's reliance on the registrant's representation, the exhibits required under the forms would no longer be necessary. In addition, the registrant would be required to file as an exhibit to the registration statement a statement by the named trustee confirming its eligibility under Section 310(a). Such a statement would be signed by the trustee, thereby assuring that the trustee had notice of being named as a trustee. Further, the registrant would be able to rely on the statement of the trustee when making its representation as to the trustee's eligibility.

In shelf offerings, where a trustee may not be identified at the time the registration statement is filed, the registrant would be required to make a representation that the trustee will be eligible (upon selection) to act under

Section 310(a) of the Trust Indenture Act and that it will provide a statement of the trustee in accordance with Section 305(b)(2) upon selection. Together, the representation and the trustee statement filed later would serve as the application for determining trustee eligibility, which is allowed to be filed on a delayed basis pursuant to Section 305(b)(2) for registered shelf offerings.

An issuer may have debt securities that are exempt from registration under the Securities Act but are nevertheless subject to the Trust Indenture Act. For such debt securities, an issuer must file a Form T-3 in addition to the applicable trustee eligibility form. If Forms T-1 and T-2 are eliminated, then Form T-3 should be modified so that the trustee eligibility information is provided in Form T-3.

In addition, if Forms T-1 and T-2 are eliminated, the rules which set forth the requirements relating to the filing of the forms (Rules 5a-1 through 5a-3 and 5b-1 through 5b-3) should be eliminated.

## **V. SMALL BUSINESS INITIATIVES**

The Commission has long recognized that small businesses play a pivotal role in ensuring the vitality of the nation's economy. Over the years, the Commission has taken numerous steps to ease the way for small businesses to access U.S. capital markets. Among some of the most significant measures taken by the Commission were the small business initiatives in 1992. As a result of those initiatives, the Commission adopted major revisions to its rules implementing Securities Act registration exemptions and established an integrated registration and reporting system for small business issuers. The Task Force makes the following additional recommendations.

### **A. LOCAL OFFERING EXEMPTION**

**Liberalize the local offering exemption by adding a "substantial compliance" provision, expanding the concept of residence for individual and business purchasers, relaxing the triple SO percent "doing business" test, and shortening the resale holding period under Rule 147 while creating a new limited exemption for certain local offerings that cross state lines.**

Section 3(a)(11) of the Securities Act permits an issuer with localized business operations to sell securities exclusively to local investors without the need to register with the Commission. The Commission promulgated Rule 147 in 1974 to provide a safe harbor under Section 3(a)(11).

Over the years, the safe harbor provided by Rule 147 appears to have been infrequently used by issuers seeking to raise capital within the borders of a single state, and critics have described the rule as unreasonably strict and narrow.

Generally speaking, in order to fall within the Rule's safe harbor, an issuer must offer and sell all of its securities only to persons who are resident of the same state in which the issuer is resident and doing business or, if the issuer is a corporation, in which it is incorporated and doing business. The Commission has narrowly construed both Section 3(a)(11) and Rule 147 to mean that if any part of an issue is offered or sold to a nonresident, even if unintentionally, the entire offering is disqualified from receiving the exemption. Even de minimis sales to non-residents trigger the disqualification.

Moreover, Rule 147 requires that, for the most recent, specified fiscal period, an issuer must have derived at least 80 percent of its gross revenues and have at least 80 percent of its assets located within the particular state. Rule 147 further requires that an issuer use within the state at least 80 percent of the net proceeds derived from the sale of the exempted securities in order to fall within the Rule's safe harbor. This "triple 80 percent" test appears to be stricter than the "predominant amount of business" test, which some courts have adopted to determine whether an issuer has satisfied the "doing business" requirement under Section 3(a)(11). See, e.g., *Chapman v. Dunn*, 414 F.2d 153 (6th Cir. 1969). The current test also appears to be stricter than the "substantial operational activities" test, which the Commission utilized for determining an issuer's Section 3(a)(11) eligibility prior to the enactment of Rule 147. The Commission explained this latter test in a 1961 release, which set forth guidelines for interpreting Section 3(a)(11). See Release No. 33.4434 (December 6, 1961).

Indications are that, because of the strict provisions of Rule 147, issuers have utilized the local offering exemption only sparingly, if at all. The Commission's goal should be to create a usable offering exemption for small issuers that reflects the realities of the nexus to more than one locality of today's small businesses. Today, an individual investor often maintains more than one residence, which makes it difficult and costly for a small company to ensure that it has truly engaged in a local offering. Further, an individual investor may be equally (or even more) familiar with companies located around his or her place of employment as those located near his or her residence.

Because some of the problems associated with Rule 147 stem from the statutory language of Section 3(a)(11) itself, the most expedient way to accomplish reform of the local offering exemption for small companies is for the Commission to both revise Rule 147 as much as the statute will allow and exercise its Section 3(b)

authority to create an expanded local offering exemption, subject to the following guidelines. The new Section 3(b) exemption would apply to any specified capital raising transaction that does not exceed \$5,000,000. Offerings greater than that amount would have to meet the more stringent requirements of Rule 147 and/or Section 3(a)(11). With this two-tier approach in mind, the Task Force makes the following recommendations for an expanded offering exemption for small companies. For each recommendation, the Task Force has noted whether it can be implemented under a revised Rule 147 exemption, a new Section 3(b) exemption, or both.

1. The Commission should add a "substantial compliance" provision similar to that contained in Rule 5Q8 of Regulation D. Under such a provision, an issuer would not lose the exemption for the entire offering by making an inadvertent offer or sale to a nonresident as long as it fulfills the following requirements: a) the issuer must have reasonably believed that the non-resident was in fact a resident; b) the number of inadvertent nonresident purchasers was de minimus; and c) the issuer must have made a good faith effort to comply with all of the Rule's provisions. The Task Force believes that the Commission could promulgate such a "substantial compliance" provision when revising Rule 147 under Section 3(a)(11). However, even if the Commission reaches a contrary determination regarding Rule 147, it should promulgate this "substantial compliance" provision as part of a new Section 3(b) exemption.
2. The Commission should clarify that the primary focus of the local offering exemption is on purchasers rather than offerees so that an issuer would not violate the rule if a non-resident inadvertently became an offeree. This would protect an issuer that utilizes newspapers of limited, albeit general, circulation or outdated mailing lists to advertise its offering. As the Commission has previously acknowledged in the above-referenced 1961 release interpreting Section 3(a)(11), as long as the issuer included the appropriate cautionary statements warning a prospective purchaser that the offering was limited to local residents, the mere fact that some non-residents read the advertisement or otherwise became inadvertent recipients of the solicitation would not disqualify the offering from receiving the exemption's benefits. The Task Force believes that the Commission could implement this recommendation under Section 3(b), as well as under Section 3(a)(11).
3. The Commission should expand the concept of residence for the purpose of determining an eligible individual purchaser. This would accommodate those investors that spend substantial amounts of time in more than one state. A person should be considered a "local" where: a) such person owns or leases a dwelling which is maintained as a personal residence; b) such person's principal place of employment or occupation is located; or c) such person is registered to vote. The Commission could act on this recommendation when revising Rule 147

under Section 3(a)(11), as well as when creating a new local offering exemption under Section 3(b).

4. The Commission also should consider expanding the concept of residence for a corporate or other business purchaser. Rule 147 currently restricts the residence of a corporation, partnership, trust or other business organization to the state in which its principal business office is located. The Commission should consider expanding the "business purchaser" residence requirement to include any state in which the business purchaser has an office from which it operates a bona fide business enterprise, provided this is the office that handles the investment in question. Again, the Commission could implement this recommendation when revising Rule 147 as well as under Section 3(b).

5. The Commission should change the determining factor of an issuer's residence to be the location of its principal place of business, regardless of the particular form of business organization involved. Rule 147(c)(1)(i) currently limits the residence of a corporation, limited partnership, trust, or other form of business organization that is organized under local law, to its place of incorporation or organization. In so doing, the Rule excludes from its scope a substantial number of business organizations that have taken advantage of another state's favorable corporate, partnership or tax laws when forming their enterprises despite maintaining their principal places of business elsewhere. The Commission should adopt a "principal place of business" residence requirement for all issuers, regardless of their business form. The Commission could implement this recommendation only under Section 3(b) since Section 3(a)(11) utilizes the term "incorporated," thereby restricting the statutory exemption to a corporation that is both incorporated and doing business within the same state of residence as its offerees and purchasers.

6. The Commission should modify or eliminate the "triple 80 percent" test by which it currently determines whether an issuer is "doing business" to qualify for the local offering exemption under Rule 147. The Commission should either substantially lower the threshold "doing business" amount under Rule 147 or eliminate it altogether and replace it with a more general "predominant amount of business" or "substantial operational activities" standard. For example, the Commission could adopt a "doing business" standard that is satisfied by the issuer having earned less than 80 percent but more than 50 percent of its gross revenues and having less than 80 percent but more than 50 percent of its assets located in the particular state. Furthermore, the Commission should consider discarding the "use of proceeds" portion of the "triple 80 percent" test. In this regard, as long as investors have recourse to an issuer, the local offering exemption would remain available if an issuer eventually uses the proceeds of a local offering to fund an out-of-state project, but otherwise continues to meet the "gross revenues" and "net asset" requirements. The Commission could

implement this recommendation both when revising Rule 147 and proceeding under Section 3(b).

7. The Commission should consider permitting an issuer to claim the local offering exemption for an offering that crosses state lines in certain limited circumstances. Such a transaction would retain its "local" character as long as it was confined to: a) a metropolitan region that is recognized as a single statistical area, such as the District of Columbia-Northern Virginia-Maryland area or the New York City-Northern New Jersey-Connecticut region; or b) an area within a certain prescribed distance (e.g., 100 miles) from the issuer's principal place of business. The Commission could implement this recommendation only pursuant to its Section 3(b) authority.

8. The Commission should consider relaxing the nine-month resale safe harbor for purchasers of securities issued in a local offering. Under Rule 147, a purchaser of local offering securities cannot resell them out of state for at least nine months following the issuer's last sale of such securities. The Task Force believes that this period may impose an unnecessary burden on the marketability of such securities. Accordingly, the Task Force recommends that the Commission curtail the nine-month period to either 90 days or six months. The Commission has previously utilized each of these periods as a measurement under the federal securities laws. For example, under Section 4(3) and Rule 174, the Commission utilizes a 90-day period to determine a dealer's prospectus delivery requirements concerning the initial public offering of an issuer that is a non-reporting company and is not traded on Nasdaq. The Commission adopted a six month period as the basis for its integration principle under Rule 147 as well as Regulation A. The Commission could implement this "shortened holding period" recommendation under both Section 3(a)(11) and Section 3(b).

9. For purposes of safeguarding investor protection, the Commission should consider excluding offerings by "blank check" and "blind pool" business organizations and direct participation investment programs from the scope of the expanded offering exemption, whether implemented under Section 3(b) or as a revised Rule 147.

## **B. REGULATION A**

**Expand the Regulation A exemption by permitting small businesses to raise five million dollars within six months rather than five million dollars per year.**

Regulation A, promulgated under Securities Act Section 3(b), provides an exemption for small offerings of up to five million dollars within a 12-month

period. However, the Commission's exemptive authority under Section 3(b) of the Securities Act is broader. It may exempt any single offering up to an aggregate five million dollars, without any explicit limitation on the number of offerings in a given time period. The Commission included a 12-month limitation to prevent companies from evading the spirit of the five million dollar limitation by making multiple five million dollar offerings within a short period of time (e.g., four five million dollar offerings which really would amount to one \$20 million non-exempt offering). The Task Force believes that the 12-month limitation may not be necessary and that the scope of the exemption for Regulation A purposes should be changed from a 12-month to a 6-month period so that \$10 million could be sold under the exemption annually. Changing the limit on the ceiling in this way would assure that small businesses have more frequent access to the marketplace and can continue to play their essential role in the success of the U.S. market system.

Alternatively, the Task Force recommends that the Commission consider revising Regulation A to permit five million dollars to be raised per offering rather than within a specific time period, applying standard integration analysis to determine when multiple offerings in fact constitute a single offering. This approach would be consistent with a recent Commission proposal regarding a California limited offering exemption. See Release No. 33-7185 (June 27, 1995). In that release, the Commission proposed a new exemption from registration for limited offerings up to five million dollars that meet the qualifications of a new California exemption, regardless of whether such offerings are separated by any particular time period. Thus, the Task Force believes that modification to an offering-by-offering rule rather than an annual ceiling would be consistent with harmonization of the federal and state regulatory scheme.

## **C. REGULATION D**

**Reduce the regulatory burden on nonreporting companies engaged in exempt offerings under Regulation D by permitting the use of uncertified financial statements when the offering amount is five million dollars or less.**

The requirements in Rule 502, relating to financial statement disclosure for non-reporting companies selling securities pursuant to Rules 505 or 506 of Regulation D, are currently inconsistent with the requirements for disclosure of non-financial information. The level of non-financial disclosure required is determined by whether the offering could alternatively be accomplished under Regulation A. If the offering amount is five million dollars or less, the issuer must provide the same kind of information as in a Regulation A offering. If not, the issuer must deliver the same kind of information as would be provided in a

registration statement under the Securities Act on the form that the issuer would be eligible to use.

The level of financial statement disclosure is similarly based upon the size of the offering, but does not depend upon the five million dollar Regulation A threshold. Instead, it depends upon three levels of offering size: a certified balance sheet is required for offerings up to two million dollars; certified financials pursuant to Regulation S-B are required for offerings from two million dollars up to \$7.5 million; and certified financials as would be provided in a registration statement under the Securities Act on the form that the issuer would be entitled to use are required for offerings over \$7.5 million. The last two disclosure categories need not be satisfied if that information cannot be obtained without unreasonable effort or expense in which event only an audited balance sheet need be provided. In addition, financial and non-financial information is required to be furnished to a purchaser only to the extent material to an understanding of the issuer, its business and the securities being offered.

In 1992, as part of the Commission's small business initiatives, the Commission considered revising the financial information requirements of Rule 502 to eliminate the requirement for certified financial statements, regardless of the size of the offering. This proposal was not received favorably and was never adopted. The Task Force recommends that the Commission consider a similar, more limited, revision to the financial information requirements. Specifically, the Task Force recommends conforming the financial information requirements to the rule's non-financial requirements so that offerings below five million dollars could contain uncertified financial statements. This recommendation also would simplify preparation of Regulation D offerings by eliminating the two different schemes for financial and non-financial disclosure.

## **VI. SIGNIFICANT CORPORATE TRANSACTIONS**

### **A. WILLIAMS ACT AND PROXY RULES**

#### **1. Consider the creation of an integrated regulation for mergers, tender offers and other extraordinary transactions.**

To promote uniform disclosure practices among similar types of transactions, the Task Force recommends that the Commission consider creating a new regulation integrating the transactional disclosure requirements of Forms S-4 and F-4 (form for registration of securities issued in mergers, exchange offers and other

business combination transactions), Schedules 14A (proxy solicitations), 14C (information statements), 13E-3 (going-private transactions), 13E-4 (issuer tender offers) and 14D-1 (third party tender offers). Much like Regulation S-K, the regulation should standardize, where appropriate, the type of disclosure among different forms of such extraordinary transactions. The Task Force believes that integration would eliminate the redundancies that currently exist by having the same disclosure item appear in the different forms and schedules where the investment and/or voting decision confronting shareholders is essentially the same. This approach also would facilitate greater uniformity in the disclosure disseminated to investors.

In formulating the new regulation, the Task Force also recommends that the Commission consider the following additional revisions. These recommendations also should be considered independently if the Commission determines not to establish a new integrated disclosure regulation:

**a. Revise proxy statement disclosure requirements.**

The disclosure requirements of proxy statements regarding mergers, consolidations, acquisitions and similar matters are contained in Items 11 through 14 of Schedule 14A. Item 11 sets forth disclosure requirements regarding authorization or issuance of securities otherwise than for exchange. Item 12 sets forth disclosure requirements regarding modification or exchange of securities. Item 13 sets forth financial and other information requirements for transactions pursuant to Items 11 and 12. Item 14 sets forth disclosure requirements regarding mergers, consolidations, acquisitions and similar matters in proxy statements.

The Task Force recommends that Items 11 through 14 of Schedule 14A be substantially revised and simplified and that conforming changes be made to Form S-4 to the extent that it contains substantially similar language and the Form S-4 proxy/prospectus procedure is not used. This recommendation is intended to clarify and simplify current rules, not to suggest that substantive modifications be effected.

**b. Clarify the treatment of cash mergers.**

Item 14 of Schedule 14A addresses the disclosure requirements for cash mergers in a complex instruction. Since very little, if any, information is necessary regarding the acquiring company in cash mergers, the Task Force recommends that Item 14 be revised to make clear that information regarding the acquirer in cash mergers is only necessary if it is material to the voting securityholder's evaluation of the proposed transaction. Such material information would include, for example, information about the acquirer's financial ability to satisfy the terms

of the offer, or potential conflicts of interest between the management of the target company and that of the acquiring company.

**c. Combine Schedules 13E-4 and 14D-1.**

Due to the substantial similarities between the disclosure required for issuer tender offers (Schedule 13E-4) and third party tender offers (Schedule 14D-1), the Task Force believes that benefits may be achieved by combining the Schedules into a uniform tender offer schedule. One major difference between the two schedules concerns their respective financial disclosure requirements. In certain respects, a Schedule 13E-4 filer must disclose more financial information than a Schedule 14D-1 bidder. These financial disclosure differences should not pose an obstacle to merger of the two schedules.

Similarly, the Commission should consider merging Schedules 13E-4F and 14D-1F together. These Schedules pertain, respectively, to issuer and third party tender offers involving certain Canadian companies. The eligibility criteria and the disclosure requirements are substantially similar for both Schedules.

**d. Move substantive disclosure requirements out of rules and into schedules.**

Some of the disclosure requirements for tender offers are set forth in the tender offer rules, while the balance of such requirements are included in Schedules 14D-1 and 13E-4. For example, Rule 14d-6(e) requires disclosure of (i) the scheduled expiration date of the tender offer and information regarding extension of that date, and (ii) information with regard to withdrawal rights. The Task Force believes that this dispersion of disclosure requirements is unduly confusing. Therefore, the Task Force recommends consolidation of all such disclosure requirements in the new integrated regulation or, if such regulation is not adopted, in the schedules.

The Task Force also recommends that any disclosure requirements for proxy statements contained in the rules rather than in Schedule 14A similarly be moved into that schedule (e.g., the date by which shareholder proposals must be submitted for inclusion in a company's proxy statement, which requirement is now in Rule 14a-5).

**2. Reduce the disclosure obligations for an investor with a passive investment purpose, who acquires or holds more than five percent but less than a certain percentage of a company's equity securities, by allowing such an investor to file a short form Schedule 13G rather than a Schedule 13D report.**

With certain exceptions, Exchange Act Section 13(d) and the regulations promulgated thereunder require a beneficial owner of more than five percent of a class of equity securities registered under Section 12 of the Exchange Act to file a Schedule 13D report with the Commission within ten days after it has exceeded the five percent threshold. The purpose of Section 13(d)'s reporting regimen is to function as an early warning system to the company, its shareholders and the markets about a potential change in control of the company.

However, the scope of the Section 13(d) reporting scheme may place an unnecessary reporting obligation on persons whose acquisitions have a passive investment purpose and thus do not involve the concerns of the Williams Act. Consequently, the Task Force recommends the following Regulation 13D revisions.

**a. Permit investors with passive investment intent to use Schedule 13G.**

The Commission should amend Regulation 13D to permit any investor, whether institutional or non-institutional, that acquires or holds more than five percent but less than a certain percentage (e.g., 10, 15 or 20 percent) of a class of Section 13(d) securities with a passive investment purpose, to file a Schedule 13G instead of a Schedule 13D. Schedule 13G is the "short form" Section 13(d) report, which primarily applies to certain qualifying institutional investors. Schedule 13G only requires minimum disclosure of certain basic items of information concerning the beneficial owner's identity and a description of the securities interest in question, and need only be filed within 45 days of the end of the fiscal year in which the threshold is exceeded. While the Commission proposed a similar amendment to Regulation 13D in 1989, it has not acted on this proposal.

The Task Force therefore recommends that the Commission revisit the 1989 proposing release and renew the debate on these issues. In determining the best method to implement this recommendation, the Task Force recognizes that the Commission may wish to take into account its intervening liberalization of the proxy rules in 1992, particularly reliance that was placed in that context upon the beneficial ownership rules. Also, in determining the appropriate beneficial ownership ceiling, the Commission again should seek comment on the level of holdings that would implicate a controlling interest.

**b. Codify staff position permitting control persons of institutional investors to file jointly with such institutional investors on Schedule 13G under certain conditions.**

Institutional investors who, as part of the ordinary management of their investment portfolios, acquire securities representing more than five percent of a

class of equity securities are required under Section 13(d) of the Exchange Act to file reports indicating their beneficial ownership with the Commission. If these securities were acquired with neither the purpose nor effect of changing or influencing the control of the issuer, and not in connection with nor as a participant in any transaction having such purpose or effect, the institutional investor is eligible to report the acquisition on Schedule 13G.

Although persons controlling such institutional investors also are considered under Commission rules to be beneficial owners of those securities, such persons are generally not eligible to avail themselves of the short form reporting privilege. Nevertheless, the staff has taken the position in no-action letters that such control persons may file jointly with the institutional investors on the short form report, provided that such control persons' individual ownership (i.e., ownership other than that which is attributable to the person by virtue of their relationship with the institutional investor) does not exceed one percent of the class of the issuer's equity securities. The Task Force recommends the codification of this staff position.

### **3. Exemptive Order For Multinational Tender Offers**

In 1991, the Commission issued a release proposing rules, forms and an order that would permit tender offers (cash or exchange) to proceed in the United States on the basis of the applicable regulation of the target company's home jurisdiction, where 10 percent or less of the class of securities sought in the tender or exchange offer is held of record by U.S. holders. See Release No. 34-29275 (June 5, 1991). No action has yet been taken by the Commission on such proposal. The Task Force has not included a specific recommendation in this Report regarding the treatment of multinational tender offers because it understands that the Commission's staff is actively working on a rulemaking proposal relating to certain of these offerings. The Task Force anticipates that in reviewing the staff's proposal, the Commission would balance carefully the need to encourage foreign issuers to extend offshore offerings to U.S. shareholders with the adequacy of the bidder's home-country disclosure requirements.

### **4. Consider permitting direct mailing of proxy soliciting materials to non-objecting beneficial owners of voting securities held of record by brokers, banks and other intermediaries.**

In 1992, the Commission adopted extensive revisions to the proxy rules in order to alleviate regulatory burdens on shareholder communications. In view of ongoing technological and other developments in shareholder communications, including possible changes in applicable state law and stock exchange requirements that overlap with the Commission's proxy regulations in this area, the Task Force recommends that the Commission consider whether an additional

revision is warranted to permit companies to mail proxy soliciting materials relating to a shareholder vote directly to non-objecting beneficial owners of voting securities held of record on their behalf by brokers, banks and other intermediaries (collectively referred to as "NOBOs"). For example, some recently amended state corporation laws and the Revised Model Corporation Act have introduced a concept of consenting beneficial holders who can be recognized as shareholders for some purposes (e.g., receipt of notices). However, the current Commission rules permit direct company mailing (or electronic delivery) to NOBOs of all communications except proxy soliciting materials (or information statements). Only if the company is willing to incur the additional cost and other burdens attendant to mailing (or otherwise transmitting) the same set of materials twice -- both to the record holders and the NOBOs -- is direct transmission of proxy and other soliciting materials permissible. Of course, some mechanism (such as use of an omnibus proxy) would have to be developed by the Commission to ensure compliance with applicable state-law voting requirements.

#### **5. Consider eliminating filing of preliminary proxy statements in contested elections of directors.**

Consistent with the Commission's previous efforts to liberalize the regulatory scheme pertaining to proxy solicitations, the Task Force recommends that the Commission permit most Schedule 14A proxy statements filed in connection with an election contest to be filed in definitive form immediately upon use. This change is consistent with the current rules in that issuers and other soliciting parties currently are allowed to use all other soliciting material immediately upon filing with the Commission. Soliciting parties also are permitted to disseminate preliminary proxy statements immediately so long as such material is not accompanied by a proxy card. This recommendation may not be appropriate where there is a significant inequality of resources among the parties to the election contest. One approach to address this concern would be for the Commission to identify an appropriate threshold based on the target company's unaffiliated market float, below which me contestants' proxy statements would not be afforded such treatment. The Task Force believes that shareholders of these target companies under the threshold may benefit from staff review of preliminary proxy material.

#### **6. Study the shareholder proposal process.**

Few areas of the federal securities laws have been as contentious as shareholder proposals under Exchange Act Rule 14a-8. The Rule, first adopted in 1942, provides a federal framework for shareholders to submit proposals to a vote of their fellow shareholders where otherwise appropriate under state law. Under the rule, public companies generally must include proposals that meet this (and several other criteria) in proxy statements sent to all shareholders at no cost

to the shareholder proponent. This provides a low cost mechanism for shareholders to communicate with one another regarding proposals they plan to raise at the meeting, using the company's proxy statement as a vehicle.

The contention arises in two primary areas: (1) what proposals should be included; and (2) what efficiencies should be added to the process. Although the debate dates back over 20 years, it seemingly has intensified as issuer groups complain that Rule 14a-8 has become a vehicle for shareholder groups to conduct referenda on social issues that many companies believe are not relevant to their business. Although the proposal and supporting statements are limited by rule to 500 words, some issuers (typically those that receive a number of proposals) argue that the cost of inclusion of these proposals outweighs any benefit to the shareholder body at large. Activist shareholder proponents, particularly proponents of social issues, counter that it is a fundamental right of shareholders to submit proposals for consideration and that major social issues (e.g., affirmative action or doing business in particular countries) are of importance to shareholders and have an impact on the company's profitability. Criticism, however, is not limited to the area of social proposals. In general, shareholders acknowledge the value of the rule in addressing issues of corporate governance.

The Task Force considered many possibilities, including raising the thresholds for submitting a proposal; removing the exclusion for ordinary business; revisiting the personal grievance exclusion; raising the threshold for resubmitting a proposal from the prior year that did not garner much support; imposing a reasonable ceiling on the number of proposals that must be included in a single proxy statement; and turning the entire process of determining which shareholder proposals should be included in a proxy statement over to the individual states. Unfortunately, no attempt at compromise appeared to address adequately the concerns of both proponents and issuers. In order to find a complete solution, the Task Force believes the Commission will need to undertake a formal and in-depth study of the entire shareholder proposal process. In the interim, however, the Commission may wish to consider suggestions received by the Task Force in favor of raising the threshold for resubmissions while at the same time considering added flexibility.

## **B. EXCHANGE OFFERS**

**1. Place certain seasoned issuer exchange tender offers on the same footing as cash tender offers by permitting such issuers' registration statements to go effective automatically upon filing.**

Under the current regulatory scheme, bidders are not required to submit cash tender offer documents for Commission staff review prior to commencement of an offer. The tender offer statement is filed with the Commission on the same day the tender offer is commenced. However, if the tender offer consideration involves the issuance of bidder securities, a bidder must file a registration statement and await its effectiveness prior to commencing the tender offer.

To place exchange tender offers on an equal footing with all-cash offers, the Task Force recommends that registration statements on Forms S-4/F-4 relating to exchange tender offers by S-3/F-3 eligible companies become automatically effective upon filing, so long as the securities offered are common stock traded on a national securities exchange or quoted in Nasdaq NMS, or are investment grade debt or preferred stock. However, automatic effectiveness would not be available for going-private or roll-up transactions.

Similar to cash offers, exchange tender offer filings still would be reviewed by the staff during the pendency of the tender offer.

Alternatively, the Commission should consider allowing shareholders to tender during the period between filing and effectiveness of the registration statement. This alternative assumes withdrawal rights during at least the waiting period and at most through the pendency of the offer and any extension thereof.

**2. In registration statements relating to exchange offers or other acquisitions involving nonreporting target companies, require only financial information about the target company that the target company has provided to its shareholders.**

In exchange offers or other acquisitions involving nonreporting target companies, audited financial statements of the target may not be readily available. The Task Force believes that it represents an unreasonable burden to require acquirers to obtain audited financials for the target when it is the target company's shareholders themselves who will be the recipients of the information. The target shareholders made an initial investment decision in the target, and then continued to hold the target's shares, without the benefit of audited financial statements. The Task Force cannot identify any significant reason why the target shareholders should receive more and different information about their company in this context than they received prior to the exchange offer.

Building on positions previously taken by the Commission staff, the Task Force recommends that the Commission require acquirers to provide only the financial information that the target has previously provided to its shareholders. As part of this recommendation, acquirers also would no longer be required to provide a reconciliation to U.S. GAAP of the financial statements of nonreporting foreign

private issuers, unless such a reconciliation was already available. This recommendation would not alter any of the existing requirements to provide pro forma financial information under Article 11 of Regulation S-X. In addition, it would not alter any of the existing requirements to provide audited financial statements pursuant to Rule 3-05 of Regulation S-X if a registration statement on Form S-4 is used for resales to the public by any person who with regard to the securities being reoffered is deemed to be an underwriter within the meaning of Rule 145(c). Furthermore, the disclosure requirements in proxy statements when the acquiror's shareholders are voting would remain the same. This recommendation also would not apply to roll-up transactions.

## **VII. REGISTRATION**

### **A. INTERNAL REORGANIZATIONS**

#### **1. Exempt certain internal holding company reorganizations from registration so long as the reorganization is the sole purpose of the transaction and fundamental shareholder rights and interests remain substantially unchanged.**

A typical internal holding company reorganization is a corporate restructuring where a holding company is created to be a parent to a pre-existing operating company and shares in the pre-existing company are exchanged pro-rata for shares in the holding company. Companies carry out such reorganizations for a variety of reasons, such as facilitation of acquisitions, joint ventures, financing and tax planning.

Under current rules, most internal holding company reorganizations, even reorganizations that do not alter important shareholder rights, must be registered under the Securities Act. As Rule 145 is currently written, the issuance of securities in connection with a merger that requires a shareholder vote must be registered. Rule 145 deems such transactions to involve an "offer" or "sale" of securities under Section 2(3) of the Securities Act. Most holding company reorganizations involve a merger between the pre-existing company and a shell company and require shareholder approval.

The Task Force recommends permitting unregistered internal holding company reorganizations, so long as the reorganization is the sole purpose of the transaction, and fundamental shareholder rights and interests are substantially unchanged. In these circumstances, there may well be no "offer" or "sale" of a new security under Section 2(3) of the Securities Act, and therefore no

registration requirement under Section 5 of that Act. Shareholders receive shares which, in reality, represent substantially the same interests and carry the same rights as those held prior to the reorganization. To implement this recommendation, the Task Force suggests revising Rule 145 to remove internal holding company reorganizations from the description of covered transactions subject to registration.

This recommendation is consistent with the theory apparently underlying recently enacted legislation in Delaware and Pennsylvania that permits internal holding company reorganizations to be carried out without shareholder approval or the availability of appraisal rights, so long as certain conditions -- evidently designed to ensure continuity of shareholder rights and interests -- are satisfied. The recommendation also is consistent with recent staff interpretive letters involving reorganizations carried out pursuant to the new Delaware and Pennsylvania laws. In the recent interpretive letters, the Division agreed that no "offer" or "sale" would be involved so long as certain additional conditions are met, including, among others, that shareholders will receive shares of the same class evidencing the same proportional interest in the holding company as they held in the pre-existing company and the rights and interests of the shareholders in the new holding company stock will be substantially the same as their rights and interests prior to the transaction. The factors cited in these recent letters would serve as a basis in formulating the proposed new rule.

The Task Force understands that the recent enactment of Section 3(a)(12) under the Securities Act, providing a transaction exemption for certain bank holding company reorganizations, may raise issues relating to the implementation of this recommendation. These issues should be addressed in the rulemaking process.

## **2. Ease financial disclosure requirements for internal holding company reorganizations that are subject to registration.**

Additional recommendations relating to holding company reorganizations follow.

### Accounting Change

When the registrant is a successor to an ongoing business for which audited financial statements have been provided for the periods specified in Rules 3-01 and 3-02 of Regulation S-X, the Task Force recommends revising Rule 3-01(a) of Regulation S-X to eliminate the requirement that the successor provide an audited balance sheet as of a date within 135 days of the date of effectiveness of the registration statement.

### Modification of Disclosure Requirements of Form S-4

The Task Force recommends that the Commission codify the staff's position that an issuer engaged in a holding company reorganization may omit from its proxy statement/prospectus filed as part of a registration statement on Form S-4 the financial and other information analogous to that information which may be omitted pursuant to Instruction 4 to Item 14 of Schedule 14A under the Exchange Act. The required information would thus be largely limited to information about the reorganization itself.

## **B. SPIN-OFFS**

### **Codify a rule permitting certain unregistered spin-offs of subsidiaries or divisions by reporting companies.**

The Task Force recommends that the Commission codify the staff position stated in a series of no-action letters that certain non-abusive spin-offs of subsidiaries or divisions of companies reporting under the Exchange Act may be effected without registration under the Securities Act, so long as the marketplace is provided with sufficient information about the entity to be spun-off. Specifically, the Task Force recommends that the Commission adopt a rule to permit unregistered spin-offs of subsidiaries of reporting issuers where shareholders receive information substantially similar to information contained in Schedule 14A or 14C, and the spun-off company registers under the Exchange Act prior to the distribution (or in the case of a foreign private issuer, provides home country information under Rule 12g3-2(b)). Consistent with the current line of no-action positions, this relief would not be available (a) in those situations where the securities being spun-off are "restricted securities (as defined in Rule 144(a)(3)) that were acquired from a third party within the prior three years; or (b) for spin-offs lacking a valid business purpose. The Commission staff receives numerous no-action requests in this subject area each year. This recommendation would save registrants the time and expense spent preparing those requests and permit Commission staff to reallocate the time spent processing such requests to other matters.

## **C. EXCHANGE OFFERINGS**

### **1. Broaden the circumstances in which the guaranteed convertible securities of a wholly owned subsidiary can be exchanged for those of its parent without the expense and delay of registration.**

Section 3(a)(9) of the Securities Act provides for an exemption from registration for certain exchanges by an issuer with its existing security holders. Often, Section 3(a)(9) exempts the issuance of securities underlying convertible

securities. However, since this exemption requires that both the security issued and the security exchanged be those of the same issuer, the availability of the exemption to wholly-owned subsidiaries that issue convertible securities guaranteed by the parent and convertible into the securities of the parent has been unclear.

The Task Force recommends building on, and broadening, a staff no-action position with respect to when two such issuers can be considered the same issuer for purposes of Section 3(a)(9). This recommendation could be implemented by modifying Securities Act Rule 149 to define the term "exchanged by the issuer with its existing security holders exclusively" under Section 3(a)(9) to include convertible securities issued by a wholly-owned subsidiary when such securities are fully and unconditionally guaranteed by the parent] and convertible into securities of the parent. The Task Force also recommends that conforming changes be made to the Rule 144 tacking provision consistent with staff no-action relief.

## **2. Codify staff positions permitting certain unregistered issuances of securities pursuant to Securities Act Section 3(a)(10) that have been subject to judicial or administrative review and approval.**

Section 3(a)(10) of the Securities Act provides an exemption from the registration requirements of the Securities Act for securities issued in exchange for other securities, claims or property interests, where the issuance has been approved by a court or by an authorized federal or state administrative body following a hearing on the fairness of the terms and conditions of the proposed issuance at which all persons to whom securities are proposed to be issued has the right to appear. The Task Force suggests that the Commission consider the appropriateness of a rule codifying the staffs position that (1) the term "any court" in Section 3(a)(10) includes foreign courts; (2) the court or administrative body must specifically consider the fairness of the terms and conditions of the exchange to the persons to whom securities are to be issued in the exchange, and (3) in making its fairness determination the court or administrative body must have sufficient information before it to determine the value of both the securities, claims or interests to be surrendered and the securities to be issued in the proposed transaction. Consistent with the staffs position, the exemption would not be available in connection with class action litigation settlements where the fairness hearing occurs prior to the time the court is provided with all terms of the settlement payment formula, and with information as to the number of persons participating in the settlement and the value of their individual claims against the issuer.

## **D. AMERICAN DEPOSITARY RECEIPTS**

Eliminate the requirement to register under Section 12(b) of the Exchange Act American Depositary Receipts registered on Securities Act Form F-6.

Under current rules, American Depositary Receipts ("ADRs") that are traded on the Nasdaq stock market or in the over-the-counter market generally are exempt from the Exchange Act registration and reporting requirements applicable to the deposited securities. ADRs that are listed on a national securities exchange are, however, subject to such requirements, as are the deposited securities to which they relate.

The Task Force recommends that the Commission eliminate Exchange Act registration for the latter category of ADRs. In these circumstances, Exchange Act registration imposes a regulatory burden with no apparent benefit to investors, since it results in no additional disclosure and creates an unwarranted distinction between N traded ADRs and exchange-listed ADRs.

## **VIII. REPORTING**

### **A. SUSPENSION AND TERMINATION OF REGISTRATION AND REPORTING OBLIGATIONS**

#### **1. Expand the circumstances in which companies may terminate registration under Section 12 of the Exchange Act.**

A company is required under Exchange Act Section 12(g) and Rule 12g-1 to register a class of its equity securities under the Exchange Act, thus incurring periodic reporting and other obligations under that Act, if it has 500 record holders and total assets exceeding five million dollars at the end of its fiscal year. Once registered, however, unless the number of holders drops below 300, a company cannot terminate its registration until it has fallen below both the five million dollar asset threshold and the 500 holder threshold. That is, even though there is no initial registration obligation unless both thresholds are met, a company may not terminate its registration even if it falls below one of them. In the case of the asset threshold, it could not terminate its registration unless its total assets have fallen below five million dollars on the last day of each of the most recent three fiscal years. The latter requirement helps to ensure that a decline in total assets below the threshold has some permanence.

The Task Force suggests that the Commission revisit the rule relating to the termination of Exchange Act registration to consider whether companies should

be permitted to terminate reporting when they fall below only one, but not both, of the thresholds. The Task Force also recommends that the requirement that the value of assets fall below five million dollars on the last day of each of the most recent three fiscal years be revised to require that assets fall below that amount on the last day of each of the most recent two fiscal years. A two-year history should in most cases be sufficient to ensure that a company's eligibility for de-registration is firmly established.

This suggestion seems consistent with the theory that only companies that meet both thresholds are large enough to be subject to compulsory registration, reporting and other obligations under Exchange Act. After all, companies are not considered large enough to be subject to an initial obligation to register until both the assets and holders thresholds are met. A company that no longer meets one of the thresholds should therefore be entitled to opt-out of registration. On the other hand, investors buying equity of reporting companies may do so with the expectation that they will continue to be public companies subject to the full regulatory scheme of the Exchange and Williams Acts.

Additionally, it has been brought to the attention of the Task Force that some companies which had previously registered under the Exchange Act when the asset thresholds were lower are effectively prevented from exiting the system, even though they would not under current rules have an obligation to register in the first place because they have five million dollars or less in assets. (The Commission increased the asset threshold from one million dollars to three million dollars in 1982, and from three million dollars to the current five million dollars in 1986. The Commission has recently proposed to raise the asset threshold to ten million dollars.) The revision proposed by the Task Force would permit such companies with less than five million dollars of total assets or less than 500 holders of record to terminate their registrations.

In making this recommendation, and the recommendation below to make similar modifications to the rules relating to the suspension of an issuer's reporting obligations under the Exchange Act Section 15(d), the Task Force is aware of the outstanding proposal to raise the thresholds for termination of registration, and suspension of reporting obligations, from five million dollars to ten million dollars. See Release No. 33-7186 (June 27, 1995). It is not the intention of the Task Force to recommend that the Commission implement both the outstanding proposal and its own recommendations. In the event that the Commission adopts the outstanding proposal, it should carefully evaluate the combined effect of that adoption and the Task Force's recommendations.

## **2. Similarly revise the rules governing when companies may suspend Section 15(d) reporting obligations.**

In connection with Exchange Act Rule 12h-3 governing suspension of reporting obligations under Section 15(d) of the Exchange Act, the Task Force recommends expanding the circumstances in which companies may suspend their Section 15(d) reporting obligations. Since the rules governing the suspension of Section 15(d) reporting obligations are substantially similar to the rules governing the termination of Section 12 registration, the Task Force recommends making the same revisions to Rule 12h-3 as to Rule 12g-1 described above.

**3. Promulgate a rule pursuant to Section 12(h) of the Exchange Act permitting the modification of periodic reporting obligations for certain companies in bankruptcy or liquidation.**

In 1972, the Commission stated that the staff would consider providing certain companies subject to bankruptcy proceedings relief from Exchange Act reporting on a case-by-case basis. See Release No. 34-9660 (June 30, 1972). The Task Force recommends that the Commission adopt a limited exemptive rule, pursuant to Section 12(h) of the Exchange Act, covering companies in bankruptcy that satisfy certain conditions. Such a rule would, in most cases, eliminate the requirement that registrants consult with the staff before modifying their reporting obligation during the pendency of a bankruptcy proceeding.

Any exemptive rule largely should track the pre-conditions for relief set forth in current no-action letters, such as the preparation of Exchange Act reports involving unreasonable effort or expense (in light of the curtailment of the company's operations), the company's securities being minimally traded, exchange-traded securities being de-listed, and the company's preparation of periodic reports under the supervision of a trustee or other court-appointed officer and undertaking to file such reports with the Commission on Form 8-K. Consistent with the no-action letters, the relief would be limited to the time that the company is in bankruptcy. Upon emerging from bankruptcy, the company would resume its full Exchange Act reporting obligations, in addition, in any future filings under the Securities Act, the company would have to provide audited financial statements for any period for which audited financial statements are required under the Securities Act, even though some portion of such periods might cover the period during which the company was in bankruptcy.

The Commission staff has provided similar relief to certain liquidating trusts, such as trusts created in connection with companies that are winding down after filing articles of dissolution with their states of incorporation. The new rule also should provide relief to such liquidating trusts.

The proposed new rule should not cover certain situations that the Task Force believes may involve potential for abuse, such as liquidating trusts established in

connection with real estate limited partnerships or trusts designed to cover anticipated environmental or other liabilities.

**4. Re-examine periodic reporting obligations under Section 15(d) of the Exchange Act to ensure that such obligations are more closely aligned with the period during which securities are actually sold.**

Section 15(d) of the Exchange Act states that an issuer that has filed a registration statement under the Securities Act that has become effective is subject to Exchange Act reporting obligations. The Task Force recommends that the Commission revisit periodic reporting requirements under Section 15(d) in order to provide clarification and avoid possible anomalous interpretations that may be inconsistent with the purposes of the Section.

A reporting obligation under Section 15(d) of the Exchange Act commences at the time a registration statement under the Securities Act becomes effective. Although a company may postpone its offering for market, business or other legitimate reasons, it has a reporting obligation even though no securities have been sold. In the Task Force's view, this reporting obligation should commence instead at the earlier of the time securities are sold or when-issued trading commences. Therefore, the Commission should consider revising its rules to implement this "springing" reporting obligation approach. Registrants, of course, could restart their Securities Act offering only with a current prospectus.

The Commission may also wish to consider other possible alternatives to ensure that reporting obligations are more closely aligned with the period during which securities are actually sold. One alternative would be to require that certain registrants with effective registration statements remain subject to reporting obligations for a fixed period of time following de-registration of their securities.

While these recommendations would likely ease the regulatory burdens on some registrants, they may in some respects increase the burdens on others. The Task Force believes that they deserve consideration in light of other recommendations contained in this Report to extend some shelf registration concepts to smaller issuers and the importance of maintaining information in the marketplace during the time period that securities are offered and sold.

**B. CONCURRENT EXCHANGE ACT/SECURITIES ACT REGISTRATION**

**1. Permit a company to register concurrently a public offering under the Securities Act and a class of securities under the Exchange Act by filing a single form that would cover both registrations.**

Under current rules, a reporting company can register a class of securities under title Exchange Act on a short form registration statement, Form 8-A. A company registering an initial public offering is permitted to use Form 8-A even though it is not technically subject to reporting until after its first Securities Act registration. Form 8-A is a short form registration form that requires only a description of the registrant's securities pursuant to Item 202 of Regulation S-K and the filing of certain exhibits.

Registrants who are concurrently registering securities under the Securities Act and the Exchange Act must file two forms, Form 8-A and the appropriate Securities Act form. Since the Securities Act form will contain or incorporate by reference all of the information called for by Form 8-A, the Task Force recommends that the Commission dispense with the requirement to file Form 8-A. In order to provide for registration under the Exchange Act, Forms S-1/F-1, S-2/F-2 (if not eliminated as recommended), S-3/F-3 and S-4/F-4 should be modified to include a box on the cover page of the registration statement that could be checked to indicate when concurrent Exchange Act registration is being made, and to include certain other information, such as title of the class of securities to be registered.

Concurrent registration would not, however, be available for a universal shelf registration statement since that document normally does not include an adequate description of the securities for the purposes of Exchange Act registration.

The Task Force also recommends that the Commission consider providing a procedural mechanism for automatically registering securities issued on a shelf takedown, such as by checking a box on Rule 424 prospectuses.

### **C. SECURITIES ACT FORM ELIGIBILITY**

1. Permit a company to switch to a shorter Securities Act form at the time of filing any amendment if it has become eligible to use the shorter form since filing its initial registration statement.

Pursuant to Rule 401 of Regulation C, the form and content of a registration statement and prospectus are determined on the initial filing date of such registration statement and prospectus. A company is not permitted to reevaluate its status until it files an amendment pursuant to Section 10(a)(3) of the Securities Act. This means that, even if a company meets the eligibility criteria to use a shorter form at the time of a pre-effective or post-effective amendment, current rules require it to file the amendment on the longer form that applied at the time of its initial registration statement.

The Task Force believes that a company should be permitted to take advantage of a form if it meets the eligibility criteria for that form at the time it files an amendment. Therefore, the Commission should permit companies to determine the appropriate form upon filing any amendment, whether it is a pre-effective amendment or a post-effective amendment. When filing an amendment other than for the purposes of Section 10(a)(3), a company would not be required to revert to a more comprehensive form than the one used for its initial registration statement.

**2. Exclude automatically effective registration statements on Form S-8 from the general rule that filings are deemed to be on the proper form unless objection is raised by the Commission prior to effectiveness.**

Paragraph (g) of Rule 401 provides that a registration statement or amendment is deemed to be filed on the proper form unless the Commission objects to the form prior to the effective date of the registration statement or amendment. To prevent abuses of this rule, the Task Force recommends that the Commission consider excluding registration statements on Form S-8, which are automatically effective upon filing. Since there is no time period between filing and effectiveness, the Commission does not have an opportunity to object to the form. Thus, the appropriateness of the form should not be governed by the effectiveness of the Form S-8 registration statement.

## **K. DISCLOSURE GENERALLY**

### **A. ENVIRONMENTAL LEGAL PROCEEDINGS**

**Eliminate the \$100,000 "one size fits all" materiality standard for certain environmental legal proceedings and replace it with a general materiality standard to ensure that companies will not be required to disclose non-material information.**

Instruction 5 to Item 103 of Regulation S-K provides guidance in connection with the disclosure of environmental proceedings. Instruction 5(A) directs the disclosure of a proceeding that is material to the business or financial condition to the registrant. Instruction 5(B) directs disclosure if the proceeding involves primarily a claim for damages, or involves potential monetary sanctions, capital expenditures, deferred charges or charges to income, and the amount involved, exclusive of interest and costs, exceeds 10 percent of the current assets of the registrant and its subsidiaries consolidated. Instruction 5(C) calls for disclosure

when a governmental authority is a party and the proceeding involves monetary sanctions, unless the registrant reasonably believes that the proceeding will result in monetary sanctions of less than \$100,000.

The Task Force recommends that the Commission revise Instruction 5(C) to replace the \$100,000 standard with a general materiality standard. Alternatively, the Commission could simply raise the dollar thresholds that trigger disclosure. The Task Force understands that in some circumstances this "one size fits all" approach may result in the disclosure of non-material information about environmental proceedings.

To address this concern, the Task Force recommends that the Commission replace the \$100,000 standard, as well as the current assets standard in Instruction 5(B), with a more flexible general materiality standard. Should the Commission implement the general materiality recommendation, consideration should be given to providing guidance in an instruction with respect to determining materiality by suggesting, for example, consideration of whether a governmental authority is a party, the nature of possible monetary sanctions, effects and potential effects on equity, future capital expenditures, cash flows, deferred charges and charges to income.

## **B. EXECUTIVE COMPENSATION**

**Consider clarifying and streamlining the rules governing when companies must disclose executive compensation information in registration and proxy statements.**

The Task Force recommends that the Commission consider the necessity or appropriateness of the following suggested changes:

- Amend S-K Item 402(i), the 10-year Option Repricing Table to reduce the look-back period from ten years to five years;
- Amend S-K Item 402(f), requiring disclosure of the Pension Plan Table, which is now widely regarded as confusing and otherwise of scant utility to shareholders attempting to track post-retirement payouts to senior executives, to require a more meaningful, individualized presentation of all ERISA and non-ERISA (top-hat) defined-benefit or actuarial plan benefits expected to be paid upon retirement to each of the five most highly compensated executive officers (as defined for Regulation S-K Item 402 purposes); and
- Provide interpretive guidance on compliance with Item 10 of Schedule 14A. Issuers reportedly have experienced some difficulty in determining what proxy

disclosure is required with respect to plans that do not fit readily within the criteria of Item 10.

The Task Force notes that the Commission has an outstanding proposal on the executive and director compensation disclosure requirements set forth in Item 402. The proposal would allow registrants to shift to the Form 10-K selected items of executive pay disclosure now required in proxy or information statements delivered to shareholders. Also proposed are amendments designed to elicit more streamlined, tabularized information on director compensation in any document requiring Item 402 disclosure. See Release No. 33-7184 (June 27, 1995).

### **C. OTHER REGULATION S-K MODIFICATIONS**

The Task Force is making several recommendations with respect to Regulation S-K that are designed to streamline disclosure, eliminate duplication, improve the disclosure elicited by the items and update thresholds. To the extent appropriate, the Task Force recommends making conforming changes to Regulation S-B.

#### **1. Streamline Item 101's disclosure requirements relating to the description of the registrant's business by eliminating duplication of quantitative information provided in the financial statements.**

Item 101 generally requires a five-year description of the development of the registrant's business; disclosure of the amount of revenue, operating profit or loss and assets attributable to each of the industry segments for the preceding three fiscal years; a narrative description of the registrant's business; and disclosure of financial information about foreign and domestic operations and export sales.

The Task Force recommends eliminating paragraph (b), relating to quantitative disclosure regarding business segments, and paragraph (d)(1), regarding quantitative disclosure of foreign operations. This information already is provided in the financial statements.

#### **2. Revise Item 102 relating to the description of property to elicit more meaningful and material disclosure.**

Item 102 requires a brief statement of the location and general character of the principal plants, mines and other materially important physical properties of the registrant and its subsidiaries. Additionally, the registrant must identify segment(s) that use the properties described and state any limitations on ownership of the property.

The Task Force believes that the disclosure provided in response to Item 102 often contains a substantial amount of immaterial information, which sometimes may obscure the material information. The Task Force, accordingly, recommends that the Commission revise Item 102 in a manner that more effectively elicits disclosure of material facts regarding a registrant's principal properties, rather than lists of properties and their immaterial characteristics.

**3. Limit the scope of Item 507, relating to securities offered for the account of a company's individual security holders, so that a company only would have to disclose information regarding certain of its selling affiliates and significant beneficial owners rather than all of its selling security holders.**

Under Item 507, if any of the securities to be registered are to be offered for the account of security holders, the registrant must name each security holder, and related information. The Task Force recommends that Item 507 be modified to require that only affiliates (as defined by Rule 144) within the last two years and beneficial holders of a certain percentage (e.g., five percent) of the registrant's securities be identified individually. The Task Force notes that there is a recent Commission proposal to reduce the Rule 144 holding period for resales by affiliates from two years to one year. See Release No. 33-7187 (June 27, 1995). If that proposal is adopted, the Task Force recommends that the Commission consider conforming the period of time for disclosure of affiliates under Item 507 from two years to one year.

**4. Move undertakings in Item 512 into a rule in Regulation C, and clarify when offers and sales may be made when a registrant has an obligation to file a Section 10(a)(3) updating prospectus.**

The Task Force recommends that the Commission make the following revisions to the undertakings required by Item 512 of Regulation S-K:

- Item 512 should be eliminated and the undertakings should be made into rules. Codifying the Item 512 undertakings will, among other things, reduce the amount of information that registrants are required to provide in Part II of the registration statement; and
- The Commission should clarify when offers and sales may be made when a registrant has an obligation to file a Section 10(a)(3) updating prospectus by post-effective amendment. For example, a registrant may file a Section 10(a)(3) updating prospectus prior to the time the current prospectus goes stale and continue to make offers and sales pursuant to that current prospectus. Once the current prospectus goes stale, the registrant then may use the Section 10(a)(3) updating prospectus to make offers. However, sales cannot be made until the

post-effective amendment containing the Section 10(a)(3) updating prospectus is effective.

**5. Eliminate Item 702's requirement to state the general effect of any arrangement regarding indemnification of a registrant's directors, officers, or control persons, which typically results in "boilerplate" disclosure of minimal value to investors.**

The Task Force recommends the elimination of Item 702 of Regulation S-K. Item 702 requires the registrant to set forth in Part II of the registration statement the general effect of any statute, charter provisions, by-laws, contracts or other arrangements under which any director or officer is indemnified against liability. The Task Force believes that the disclosure elicited by this Item has become boilerplate and of little value to investors and that any concerns should be adequately addressed if the Commission modifies Item 510 to add a new paragraph (b) that would apply to registration statements that are to become effective by Commission action, and to registration statements on Form S-8. This new paragraph would require that the registrant disclose in the prospectus that it will perform the matters that are now the subject of the Item 512(h) undertaking, such as that the registrant will submit indemnification provisions to a court for a determination of validity whenever directors and officers are indemnified against liability. Item 512(h) should then be eliminated.

**6. Adjust certain dollar thresholds in Regulations S-K and S-X for inflation since the time of their adoption.**

The Task Force recommends that the following thresholds be adjusted for inflation (determined by accounting for the passage of time since the thresholds were originally set and rounding to an appropriate whole number):

- The \$60,000 threshold in paragraph (a) of Item 404 of Regulation S-K (relating to disclosure of a registrant's transactions with management and others) should be increased to \$100,000. The \$60,000 threshold was established in 1983. That number, converted to current dollars based on the CPI-U Index, would be \$92,590 today;
- The \$50,000 threshold set forth in the instructions to Item 509 of Regulation S-K (relating to disclosure of payments to experts and counsel) should be increased to \$100,000. The \$50,000 threshold was established in 1982. That number, converted to current dollars based on the CPI-U Index, would be \$79,637 today;
- The \$100,000 threshold set forth in Rule 3-11 of Regulation S-X (relating to the definition of an inactive registrant) should be increased to \$200,000. The

\$100,000 threshold was established in 1980. That number, converted to current dollars based on the CPI-U Index, would be \$186,529 today; and

- The threshold set forth in Rule 144(h) for filing of a Form 144 should be revised from the current level of sales over 500 shares or an aggregate sales price in excess of \$10,000 over a three-month period. The \$10,000 threshold was established in 1972. That number, converted to current dollars based on the CPI-U Index, would be \$36,000 today. For small business issuers, the threshold for filing a Form 144 should be raised to 500 shares or \$40,000. For issuers who are not small business issuers, the threshold should be increased further to 1,000 shares or \$100,000.

## **D. EXHIBITS**

### **1. Create a new exhibit form, which would enable a company to file most of its exhibits on one form, thereby making such exhibits easier to locate and update.**

The Task Force recommends consolidating all exhibit filings into a single "supplemental information" Form EX, filed as a separate Section 13(a) or 15(d) report. Under current rules, locating a specific exhibit can be extremely difficult for registrants and investors alike, as every filing requires its own set of exhibits and an exhibit may not be physically attached to a particular filing that calls for it, since exhibits are often incorporated by reference from previous filings. Adding to the confusion, different filings often bear different file numbers, so a search for exhibits often must follow a few different trails.

The recommendation to consolidate all exhibits would greatly simplify matters. A person looking for an exhibit typically would have to look in one place. There would, however, be a few exceptions. For instance, exhibits that relate directly to a specific filing, such as consents and opinions, would continue to be filed with such filing. Annual reports to shareholders incorporated into, and included as an exhibit to, a Form 10-K filing would continue to be filed with such filing.

In addition, in the context of offerings of asset-backed securities, registrants would no longer be permitted to file a form of prospectus supplement as an exhibit to the registration statement. They would, instead, be filed within Part I of the registration statement.

The filing would be "evergreen" in that it would be continuously updated by the registrant. Stale exhibits could be withdrawn by the registrant for liability purposes, but would continue to be publicly available.

## **2. Permit automatic effectiveness of a post-effective amendment filed solely to add an exhibit.**

Following effectiveness, companies may update their registration statements to include new consents or opinions. Under current rules, registrants eligible to use Forms S-3/F-3 may file updated exhibits post-effectively on Form 8-K. The exhibit is then automatically incorporated by reference into its prospectus. By contrast, registrants that are not eligible to use Form S-3/F-3 can accomplish the same thing only by way of post-effective amendments, which are subject to possible staff review.

In order to facilitate the filing of updated exhibits by non-S-3/F-3 registrants, the Task Force recommends that the Commission adopt a rule to permit any post-effective amendments filed solely to add exhibits to be effective automatically upon filing.

## **3. Eliminate specific exhibits that appear to be rarely used or contain information that is otherwise available.**

In the course of its review of the exhibit requirements in Item 601 of Regulation S-K, the Task Force identified five exhibits that should be eliminated either because the information contained in the exhibit appears to be infrequently used or because the information is otherwise available. Under Rule 418, the documents would nonetheless be subject to a specific staff request to provide a copy supplementally to the staff to aid its review of a filing or to publicly file the document as an exhibit. The exhibits that should be eliminated are as follows:

- Opinion re discount on capital shares (Exhibit 6);
- Opinion re liquidation preference (Exhibit 7);
- Statement re computation of per share earnings (Exhibit 11);
- Material foreign patents (Exhibit 14); and
- Information from reports furnished to state insurance regulatory authorities (Exhibit 28).

## **E. INDUSTRY SPECIFIC DISCLOSURE**

**Modernize the existing Industry Guides, consider adopting additional industry-specific disclosure rules, and relocate all such guides and rules within Regulation S-K.**

There are currently seven Industry Guides, which provide disclosure guidance with respect to gas and electric utilities (Guide 1), oil and gas operations (Guide 2), statistical disclosure by bank holding companies (Guide 3), oil and gas drilling programs (Guide 4), partnerships and REITs (Guide 5), property casualty insurance claims (Guide 6) and significant mining operations (Guide 7).

Although the Industry Guides are reflected in the table of contents to Regulation S-K, they are technically and physically separated from that Regulation. The Task Force understands that many registrants find this separation confusing. The Industry Guides should, therefore, be incorporated into Regulation S-K and placed intact at the end of that Regulation in the manner that industry-specific disclosure requirements are currently placed in Regulation S-X. The Commission also should consider adopting rules to provide disclosure guidance for transactions in other specialized industries, such as real estate and asset-backed transactions.

The Task Force, additionally, recommends that all of the industry-specific disclosure requirements be modernized. Although a more detailed review would undoubtedly highlight other appropriate changes, the Task Force has the following specific recommendations:

- **Guide 1 (Gas & Electric Utilities)**

Eliminate this Guide. The information appears to be adequately covered by the requirements of Regulation S-K (principally Items 101 and 303).

- **Guide 2 (Oil & Gas Operations)**

- Eliminate the reference to Rule 4-10(k). This reference is obsolete.

- Consider codification of all (or certain) SABs and ASRs relating to oil and gas into Guide 2 or Rule 4-10 of Regulation S-X.

- Eliminate the proviso stating that certain limited partnerships and joint ventures with oil and gas drilling programs need not comply with Guide 2. Drilling programs should be required to provide the disclosure required by Guide 2 to the extent available.

- **Guide 3 (Statistical Disclosure by Bank Holding Companies)**

- Update to accommodate changes in the economic, accounting and regulatory environments impacting banks and related entities. Reflect the impact of (and

conform the disclosure requirements to) recently issued accounting standards, such as SFAS 91, SFAS 114, SFAS 115 and SFAS 118. Numerous disclosures that duplicate GAAP and certain disclosures that may no longer be necessary can be eliminated. Clarify and incorporate SAB 69 into revised Guide 3.

- **Guide 5 (Partnerships & REITs)**

- Overall revisions to this Guide are necessary to reflect subsequent changes in the economic environment relating to real estate companies, disclosure rules, GAAP and staff policies. Consolidate into Guide 5 changes that were adopted in Release No. 33-6900 (June 17, 1991) and certain of the requirements of Form S-11. Revise to eliminate duplicative disclosures required by Regulation S-K and certain other non-substantive disclosures. Other changes that should be considered include:

- Eliminate all prior performance tables, except for Table EI (operating results of prior programs), and modify Table EI to incorporate some useful portions of the other tables;

- Clarify Item 19C regarding when "broker-dealer only" material is subject to staff review;

- Codify staff practice of requiring information in reports on Form 10-K information that is similar to that required by Items 13 and 14 of Form S-11; and

- Staff practice has been to apply the disclosure guidelines and requirements of Guide 5 and Release No. 33-6900 to offerings that are substantially similar to those subject to those requirements. For example, blind pool partnerships, through practice, comply with certain disclosure guidelines in Guide 5 relating to prior performance information. In addition, these partnerships also provide the undertakings set forth in Item 20 of Guide 5 which relate to the filing requirements of prospectus supplements and post-effective amendments. Blind pool REITs, due to their similarity to partnerships, also comply with these requirements. The Task Force recommends that the practice of compliance with these disclosure guidelines and filing requirements be codified among the industry-specific rules. These requirements would apply to offering documents relating to ongoing partnership offerings, or offerings of a similar nature, without limitation to the real estate industry. This would be consistent with the Commission's interest in providing investors in partnership offerings with clear, concise information on an ongoing basis.

- **Guide 6 (Property Casualty Insurance Claims)**

In order to accommodate the recommended elimination of Article 7 of Regulation S-X, incorporate the provisions of note 6 to Rule 7-03(a) of Regulation S-X (which requires disclosure of investments in excess of 10 percent of equity).

- Guide 7 (Significant Mining Operations)

Revise and simplify the following definitions in Guide 7. One approach would be as follows:

***(2) Proven (Measured) Reserves:*** Reserves for which (a) quantity is computed from dimensions revealed in underground workings and/or drill holes, outcrops, and trenches; grade and/or quantity are computed from the results of detailed sampling and (b) the sites for inspection, sampling, and measurement are spaced so closely and the geologic character so well defined that size, shape, depth, and mineral content of reserves are well established.

***(4)(i) Exploration Stage --*** Includes all issuers in search for mineral deposits (reserves) which are not in either the development or production stage. Such an issuer may indicate the size of a mineralized area and describe briefly the geologic, geotechnical, sampling and other such surface work which could warrant testing in depth.

***(4)(ii) Development Stage --*** Includes all issuers that have intersected a mineralized deposit with a sufficient number of drill holes, pits, or underground sampling to determine sufficient tonnage and average grade. This deposit does not qualify as a commercially viable ore body (reserves) until a final economically feasible study based upon such work is concluded.

These revisions are intended to provide clarification to the current definitions and current staff positions. They are not intended to make any substantive modifications to the definitions and current positions.

-- Correct the following technical errors:

-- In the second paragraph of subparagraph (a)(1), replace the words "oil, shale, tar, sands" with "oil-shale, tar-sands;"

-- In subparagraph (b)(7), replace the word "geographic" with the word "geologic;" and

-- In subparagraph (c)(1)(i), insert the word "data" after "sample-assay. "

## **F. STAFF LEGAL BULLETINS**

**Consider publishing "Staff Legal Bulletins" to announce significant legal interpretations of interest to a wide group of issuers.**

There are several ways in which the Commission and the staff provide companies and the private bar with guidance in complying with the securities laws. Among these are interpretive releases, informal written requests for no-action interpretive advice and oral requests for such advice. The Task Force recommends that the Commission staff consider adopting another means of providing interpretive advice similar to the Staff Accounting Bulletins (or "SABs") issued by the accounting staff of the Commission. Such "Staff Legal Bulletins" would describe significant interpretive positions of interest to a wide group of issuers. The bulletins should be made widely available through traditional means as well as on the Commission's Internet World Wide Web site.

## **G. EDGAR**

**1. As part of the study regarding the EDGAR filing system, consider whether certain EDGAR forms should be eliminated at some future date.**

The Task Force has considered suggestions that certain Electronic Data Gathering, Analysis, and Retrieval ("EDGAR") forms be eliminated. However, because of the architecture of the Commission's EDGAR system, the Task Force is not recommending any changes with respect to the existing forms.

EDGAR processes and disseminates most filings made by, or with respect to, domestic companies. Electronic filers must identify their filings in accordance with the EDGAR Filer Manual so that the EDGAR system can understand and process them consistently with the Commission's recordkeeping system. Compliance with the formatting requirements also is necessary to allow the Commission staff and the public to easily retrieve electronic filings and locate information contained in them.

The architecture of the EDGAR system is currently being reevaluated. See Release No. 34-36683 (January 5, 1996). As part of this reevaluation, basic issues as to how EDGAR filings should be structured, presented, formatted, filed, processed and disseminated are being considered. During the EDGAR contract recompetition, the Task Force recommends that the automated processing functions of EDGAR be reviewed to determine if and where the system could be simplified and made more user-friendly, without diminishing its utility -- for example, by establishing a program that assists the filer in selecting the appropriate form type.

**2. Enable EDGAR filers to receive certain filing date adjustments without the need for a case-by-case determination by the staff as to whether the request should be granted.**

Under current rules, an electronic filer must petition the staff for a filing date adjustment where the filer has in good faith attempted to file a document with the Commission in a timely manner but the filing was delayed because of technical difficulties beyond the filer's control. The Task Force believes that it may be appropriate to provide for filing date adjustments for certain routine filings without the need for a case-by-case staff determination. For example, a filing date could be adjusted automatically for an Exchange Act report filed no more than a specified number of days late when a company certified that it made good faith efforts to file the report on or before the due date but was prevented from doing so by technical difficulties beyond its control. This would be consistent with the treatment of notices of late filing under Rule 12b-25 under the Exchange Act and temporary hardship exemptions under Regulation S-T and would benefit the filers and the staff by reducing the time currently required to prepare and process requests for adjustments. In non-routine matters, such as tender offers, staff involvement with filing date adjustments would continue.

**3. Pursue an electronic linkage of EDGAR with the exchanges, Nasdaq and NASAA.**

The Task Force recommends that the Commission continue to pursue the establishment of an electronic linkage to EDGAR for the exchanges, Nasdaq and the states, through NASAA. Under current rules, paper copies of registration statements and other disclosure documents that are filed with the Commission must be simultaneously provided to each exchange upon which the registrant's securities are listed. These paper delivery requirements apply even to companies that currently make electronic filings with the Commission. The Task Force understands that Commission filings provide information about the registrant needed by exchanges and Nasdaq in order to enforce their regulations. The same is true with regard to many securities filings required to be made with the states. The establishment of an electronic linkage would both facilitate the regulatory processes of the exchanges, Nasdaq and the states, as well as eliminate requirements that registrants deliver to them extra paper copies of Commission filings.

**X. TRADING PRACTICES RULES**

**A. DISCUSSION OF THE TRADING PRACTICES RULES**

To prevent manipulative activities during offerings of securities, the Commission has implemented a series of rules under the Exchange Act, which are referred to as the trading practices rules and include Rules 10b-6, 10b-6A, 10b-7, 10b-8, and 10b-21. These rules are meant to protect the integrity of the offering process by precluding persons with a stake in the offering from activities that could influence artificially the market for the offered security.

Rule 10b-6 is a prophylactic rule that prohibits issuers, underwriters, and others participating in a distribution from bidding for, purchasing, or inducing others to purchase the offered securities or related securities during the distribution. Rule 10b-6 contains exceptions from its general prohibitions that are designed to accommodate market activities consistent with the rule's anti-manipulation purpose. Rule 10b-6A permits "passive market making" (i.e., transactions that follow, but do not lead, the market), by Nasdaq market makers participating in distributions of Nasdaq securities. Rule 10b-7 prescribes the parameters for stabilizing activity, i.e., transactions made to facilitate an offering of a security by preventing or retarding a decline in the open market price of any security. Rule 10b-8 pertains to distributions of securities being offered through rights, and restricts the prices at which rights may be purchased as well as the prices at which the securities being distributed, or securities of the same class and series, may be sold. Rule 10b-21 prohibits persons who engage in short sales in anticipation of a public offering from covering such sales with securities obtained from an underwriter, broker, or dealer who is participating in the offering.

The securities markets have changed dramatically since these rules were implemented or last significantly amended. These changes include the expanded role of institutional investors, new kinds of trading instruments and strategies, enhanced transparency of securities transactions, expanded surveillance capabilities of the self-regulatory organizations ("SROs"), increasing globalization of securities markets, and transformation of the capital raising process. To address whether these changes warrant revision or even rescission of the trading practices rules, in 1994 the Commission issued a release commencing a comprehensive reexamination of the rules and the concepts underlying them.

Upon reviewing these rules and comments received in connection with the concept release, the Task Force recommends that significant revisions be made to the structure and scope of the trading practices rules. The rules are unnecessarily complicated, rigid, and onerous, making both compliance with, and administration of, their provisions difficult. Moreover, Rule 10b-6 in particular covers classes of issuers and transactions that are broader than necessary, particularly given today's trade reporting and surveillance capabilities. In our view, fundamental changes to these rules can be made, thereby reducing

impediments to capital formation, but without undermining their important investor protection goals.

## **B. RECOMMENDATIONS**

**Replace the trading practices rules, which have become unnecessarily complicated and burdensome, with a new, streamlined, more understandable regulation that would restrict a narrower range of activities, persons and issuers.**

The Task Force recommends that the trading practices rules be completely rewritten in a manner that would both simplify these rules and narrow their application. For example, Rule 10b-6 applies during distributions of securities of almost all issuers, regardless of their size, and during a period generally commencing before offers or sales begin -- even if the offering is not priced for another month or more. The Task Force believes that prophylactic trading restrictions are no longer necessary for such a lengthy period, and that underwriters and broker-dealers, at least, need not be restricted so comprehensively with respect to such a broad class of securities. By shortening the time frame of many of the restrictions and, in the case of underwriters and broker-dealers, focusing them upon less actively-traded issuers, the Task Force believes the Commission could ease substantially the burdens imposed by the trading practices rules while reducing their complexity.

The Task Force's proposed narrowing of the trading practices rules would not confer a license to manipulate in non-covered transactions. All activities in connection with an offering of securities, whether or not within the scope of the restructured trading practices rules, would remain subject to Rule 10b-5 and other general anti-fraud and anti-manipulation statutory provisions and rules. The Task Force believes that the SROs should play an integral role in this revised regulatory scheme: to help guard against abuse, the SROs should expand their surveillance capabilities in connection with securities offerings.

Under the Task Force's recommendation, the Commission would adopt a new regulation to replace the existing trading practices rules. This regulation would employ a number of provisions of the Securities Act and Exchange Act.

The provisions proposed to replace Rule 10b-6 would be contained in two rules: one rule covering underwriters, prospective underwriters, and broker-dealers participating in a distribution (collectively "underwriters"); and the other rule covering issuers and selling securityholders. Depending on the security's characteristics, the restrictions under these new rules would not commence until

one business day or five business days prior to the pricing of the offered security, the principal event meriting regulatory protection.

Especially given the narrower application and shorter restricted period of the new rules, the current complex series of exceptions to Rule 10b-6 could be streamlined considerably. The securities subject to the rule governing underwriters would be limited primarily by the addition of an exception covering actively-traded securities. The Task Force also recommends adding other exceptions to this rule to cover all distributions to QIBs of Rule 144A-eligible securities (the current exception covers Rule 144A-eligible foreign securities only), de minimis transactions, routine dissemination of research reports, options exercises, and transactions in baskets of securities. These new exceptions would respond to specific concerns raised by commenters.

In the rule governing issuers and selling securityholders, the Task Force recommends that the existing exception for issuers' plan transactions be broadened to give these plans greater flexibility.

Issuers and selling securityholders, unlike underwriters, lack the legitimate independent business reasons to engage in trading during a distribution. In addition, as principals in the distribution, they might have a greater incentive to influence the market to maximize offering proceeds. Therefore, most of the exceptions applicable to underwriters would be unnecessary or inappropriate for inclusion in this rule.

Rule 10b-6A, adopted in 1993, is an exception to Rule 10b-6 for passive market making in certain Nasdaq securities. Passive market making is limited to certain firm commitment, fixed price offerings when distribution participants account for at least 30 percent of Nasdaq trading volume in the security. The Task Force recommends that the new rule proposed to replace Rule 10b-6A relax current eligibility criteria, thereby permitting Nasdaq passive market making in a greater number of offerings and securities.

The Task Force recommends that the new rule proposed to replace Rule 10b-7 provide greater flexibility for stabilizing transactions. Among other things, this rule should allow underwriters to follow the independent market for a security, eliminate the distinction in the current rule between exchange-traded securities and over-the-counter securities, and permit stabilizing levels to refer to prices reported in the security's principal market, wherever located. The Task Force further recommends that information on stabilizing and other market activities be written in "plain English," and be tailored to the particular offering. This will provide more useful disclosure to investors about underwriters' potential market activities than is provided by the current boilerplate language.

Because stabilizing is activity specifically intended to influence a security's market price, the stabilizing rule would not be limited to the shortened time period applicable to the other restructured trading practices rules that are recommended by the Task Force, and would not include an exception for actively-traded securities. To harmonize treatment of foreign and domestic issuers' securities, the Task Force recommends that the current rule's exception for distributions to QIBs of Rule 144A-eligible foreign securities be expanded to cover all Rule 144A-eligible securities.

The Task Force recommends that Rule 10b-8 be rescinded because it is not necessary to have a detailed, complex rule pertaining solely to distributions through rights. In the proposed new rule governing the activity of underwriters, the Task Force recommends replacing the current exception for Rule 10b-8 transactions with a new exception permitting bids or purchases of rights during the rights offering.

Finally, in light of the narrow scope of Rule 10b-21, and the adoption of other regulatory measures that address short selling activity, the Task Force questions whether it is necessary to have a special regulation to deal exclusively with this activity. A number of commenters maintain that the current rule is too easily circumvented and does not capture adequately conduct that can depress artificially a security's price shortly before the offering price is determined. Since the initial adoption of the rule in 1988, the NASD has implemented a short sale rule on a pilot basis, and the Commission has adopted the Nasdaq passive market making rule; both may reduce the need for Rule 10b-21. Further, in the absence of this rule, short selling to depress an offering price would continue to be covered by the general anti-fraud and anti-manipulation provisions of the Securities Act and Exchange Act. Therefore, the Commission should seek comment on whether Rule 10b-21 continues to be necessary or appropriate, or whether the rule should be amended to cover transactions in related securities.

## **XI. ACCOUNTING DISCLOSURE CHANGES**

In formulating its recommendations concerning potential accounting disclosure changes, the Task Force received suggestions from a number of participants in the financial reporting process. Many of the Task Force's recommendations mat follow reflect the input received from these participants. Other suggestions -- such as integration of the financial reporting requirements of Regulation S-X with the narrative disclosure requirements of Regulation S-K in one comprehensive package and another to modify the interim reporting scheme -- will be considered as part of a longer-term review.

These suggestions are important, however, and they will be considered as part of a longer range project to evaluate the recommendations of the various private sector organizations that have issued reports on the information needs of users of financial information. Those reports make a number of recommendations to enhance the utility of financial reporting that will be considered by accounting standard setters, predominately the FASB, and by regulators, such as the Commission.

Further, the proposed revisions to Rule 3-05 of Regulation S-X, with respect to financial statements of acquired businesses (see Release No. 33-7189 (June 27, 1995)), were not duplicated in this Report. If adopted, the proposals would eliminate the requirement to provide audited financial statements for certain pending acquisitions and generally would allow registrants to provide information about consummated significant acquisitions in Securities Act registration statements on the same time schedule as for Exchange Act reporting. In addition, the proposed rules also would provide an automatic waiver of the earliest year of required financial statements otherwise required in certain cases when the financial statements are not readily available.

**A. Permit companies to "income average" when determining the significance of acquisitions and equity method investments, thereby refining the circumstances when the company must provide separate financial statements to those instances where the acquisition or investment is truly significant.**

In addition to their own financial statements, registrants are often required to present separate audited financial statements of other persons in filings with the Commission. The two most common situations where separate audited financial statements of another person are required in a registrant's filings relate to (1) business acquisitions where the acquired business exceeds 10 percent in significance and (2) financial statements of equity method investees when the significance of the investee to the registrant exceeds 20 percent. Significance is measured using the three significant subsidiary tests of Rule I-02(w) of Regulation S-X, one of which is a comparison of the investee's income to the registrant's income. Under current rules, if the registrant's income for the most recent fiscal year is 10 percent or more lower than the average of the last five fiscal years, the registrant may elect to use the average income for purposes of determining significance under the significant subsidiary tests (thereby reducing the level of significance of the investee and eliminating or reducing the requirements to present its audited financial statements).

However, the rule allowing registrants to income average is not applicable if the registrant reported a loss, rather than income, in the latest fiscal year. In such circumstances, the test could operate to require unnecessary disclosure,

particularly with respect to companies with relatively small losses in the latest fiscal year.

The Task Force proposes changing the rules to allow registrants to income average, for purposes of determining significance, whenever the registrant's income or loss for the most recent fiscal year is 10 percent or more lower than the average of the last five fiscal years.

Implementation of this recommendation would require a revision to the definition of "significant subsidiary" in Rule 1-02(w) of Regulation S-X.

**B. Reduce the effect of the 45-day "black out" period during which many registrants are effectively prevented from undertaking a public offering by narrowing the scope of the accounting rules requiring updated audited financial statements in certain registration statements declared effective 45 days after the registrant's fiscal year end.**

The Exchange Act generally requires filing of audited annual financial statements of a registrant 90 days after the end of the registrant's most recently completed fiscal year. However, unless the registrant meets the requirements of Rule 3-01(c) of Regulation S-X (relating to expected profits for the most recent fiscal year and a history of profitable operations), registration statements filed under the Securities Act must include audited financial statements of the registrant for the registrant's most recent fiscal year if the registrant statement is declared effective more than 45 days after the registrant's fiscal year. This requirement to provide updated audited financial statements 45 days after a registrant's fiscal year is difficult for many registrants to satisfy, and in some circumstances, prevents a registrant from filing a Securities Act registration statement during this 45-day "black-out" period. The Task Force believes that the requirement to provide updated audited financial statements in Securities Act filings sooner than required under the Exchange Act should be eliminated for repeat issuers. This recommendation would not alter current requirements relating to initial public offerings under the Securities Act.

**C. Expand the circumstances in which a company may incorporate by reference audited financial statements of significant investees so that such statements need not be reproduced in filings with the Commission.**

Under Rule 3-09 of Regulation S-X, registrants are required to provide audited financial statements of significant investees accounted for under the equity method. An investee is "significant" if the registrant's investment exceeds 20 percent of the registrant's total assets or the investee provides more than 20 percent of the registrant's income. The Task Force recommends clarifying current rules to state more explicitly that registrants may incorporate such financial

statements by reference in all reports and filings under the Exchange Act (and, consequently, that registrant's filing on Forms S-3/F-3 may incorporate by reference their Exchange Act reports containing such financial information). The Task Force also recommends permitting issuers eligible to use Forms S-1/F-1 that have been reporting for 12 months to deliver the financial statements of "significant investees" in lieu of restating them in the prospectus, and to incorporate by reference financial statements of significant investees that are eligible to use Forms S-3/F-3. The Commission should consider whether such relief should be extended to all classes of issuers.

**D. Streamline the complex and often confusing rules requiring separate audited financial statements of affiliates whose stock collateralizes a registrant's securities, and of persons who guarantee a registrant's securities.**

Rule 3-10 of Regulation S-X requires separate audited financial statements of each affiliate whose stock constitutes a significant portion of the collateral for any public issuance of the registrant's securities. In addition, Rule 3-10 requires a registrant to file separate audited financial statements of each guarantor of the registrant's publicly issued securities. Rule 3-10, as currently written and interpreted by the staff, can lead to multiple sets of financial statements. In many situations, such financial statements may be of limited usefulness to investors. The Task Force believes that simplification and streamlining of this rule is necessary. The following recommendations have been divided into two separate recommendations, the first dealing with collateralizations and the second dealing with guarantees.

Financial statements of affiliates whose stock collateralizes securities of a registrant.

Rule 3-10 currently provides that the collateral is significant, and thus audited financial statements of the affiliate whose stock constitutes the collateral are required, when the book value, fair value or market value of the collateral exceeds 20 percent of the principal amount of the secured class of securities. The Task Force recommends that audited financial statements of the affiliate should only be required when the value of the securities of the affiliate which collateralize the securities of the registrant exceeds 40 percent of the principal amount of the secured class of securities. If the value of the collateral constitutes between 20 percent and 40 percent of the principal amount of the secured class of securities, the Task Force recommends the rules be revised to require only condensed financial statements of the affiliate. Such condensed financial information could be placed in an audited footnote to the registrant's financial statements, provided, however, the affiliate is consolidated with the registrant.

Alternatively, the Commission could require such information in a schedule pursuant to Rule 5-04.

#### Financial statements of guarantors.

The rules requiring separate financial statements of each guarantor of a security are currently contained in SAB 53 and Rule 3-10 of Regulation S-X, as interpreted through various no-action positions taken by the Division staff. In addition, the guarantor (if a subsidiary of the issuer) or the issuer (if the issuer is a subsidiary of the guarantor) must file periodic reports under the Exchange Act unless it obtains Section 12(h) reporting relief. This relief normally is granted only if the guarantor or the issuer is wholly-owned and the guarantee is full and unconditional. The current financial statement requirements for guarantors are complex, provide for multiple outcomes depending on the corporate structure of the registrant and the level of significance of any non-guaranteeing subsidiaries and are not understood by many registrants.

The Task Force recommends that the Commission simplify the reporting alternatives under Rule 3-10 and SAB 53 and clarify the definition of wholly-owned subsidiary to be consistent with the definition of General Instruction J of Form 10-K. The Task Force recommends that, if the guarantee is full, unconditional and joint and several, the Commission require either summarized consolidating financial information or condensed consolidating financial statements, depending upon the significance of any non-guaranteeing subsidiaries. This would greatly simplify Rule 3-10 and SAB 53 and actually provide more useful information to investors than is currently provided in many circumstances. If only summarized consolidating financial information is required, it should be on the condition that in the event of a default on the security or other events which increase the need for disclosure of information relating to the issuer or guarantor, the level of disclosure increases and condensed consolidating financial information or full financial statements would be required. If the guarantees are not full, unconditional and joint and several, or the affiliate is wholly-owned, separate audited financial statements would continue to be required.

### **E. ELIMINATION OF ACCOUNTING RULES**

#### **Streamline accounting and related disclosure requirements by eliminating duplicative rules and those rules that have outlived their usefulness.**

The accounting and related disclosures required in Commission documents are governed by GAAP and the rules and regulations of the Commission. GAAP applies to all companies, while the rules and regulations of the Commission apply

primarily to public companies. Therefore, when preparing Commission documents, registrants must comply with GAAP as well as Commission accounting rules, most of which are contained in Regulation S-X. In many cases, the Commission adopted rules that were subsequently codified by the Financial Accounting Standards Board (EASE) as a part of GAAP. In addition, when more than one independent body is making rules for disclosure for different but overlapping populations, it is inevitable that some duplication will occur. As a result, over the years, redundancies have developed between the FASB accounting rules and Regulation S-X.

The recommended changes made to the accounting items listed below are intended to eliminate Commission accounting rules where information required under a rule is substantially duplicative of information required by the current accounting literature, or where the accounting rule has otherwise outlived its usefulness.

- **Eliminate Rule 3-12 of Regulation S-X.**

Rule 3-12 sets forth the requirements regarding the age of financial statements at the effective date of a registration statement or at the mailing of a proxy statement. This rule largely duplicates the information contained in Rules 3-01 and 3-02. Therefore, the Task Force recommends the elimination of Rule 3-12 and the merging of any non-duplicative portions into Rules 3-01 and 3-02.

- **Eliminate subparagraph (a) of Rule 3-15 of Regulation S-X.**

Subparagraph (a) of Rule 3-15 relates to the format of the income statement and balance sheet of real estate investment trusts (REITs). This rule is no longer necessary because GAAP adequately provides for the formatting of the balance sheets and income statements for REITs.

- **Eliminate Rule 3-16 of Regulation S-X.**

Rule 3-16 sets forth the requirements for registrants that have emerged from a corporate reorganization. This rule may be eliminated because the disclosures required by GAAP (including SOP 90-7, "Reorganizations Under the Bankruptcy Code") and Item 303 of Regulation S-K (management's discussion and analysis) are adequate and cover the information required in Rule 3-16.

- **Eliminate Rule 4-05 of Regulation S-X.**

Rule 4-05, relating to current assets and current liabilities when a company's operating cycle is longer than one year, may be eliminated because current GAAP disclosures are adequate.

- **Eliminate Rule 4-06 of Regulation S-X.**

Rule 4-06 requires that reacquired indebtedness of a registrant must be deducted from the appropriate liability caption on the registrant's balance sheet. The Task Force believes that this rule is unnecessary because GAAP, including current accounting practices, requires that such items reacquired should be deducted from the appropriate caption on the balance sheet.

- **Eliminate Rule 4-07 of Regulation S-X.**

Rule 4-07, relating to the mandated balance sheet presentation for discounts on shares, should be eliminated because it is outdated and unnecessary.

- **Eliminate subparagraphs (f) and (k)(1) and modify subparagraph (m) of Rule 4-08 of Regulation S-X.**

Rule 4-08 relates to the general notes to the financial statements. Subparagraph (f), relating to significant changes in bonds, mortgages and similar debt, and subparagraph (k)(1), relating to related party disclosures, should be deleted from Rule 4-08 because disclosure under current GAAP, including SFAS 57, appears to be adequate.

In addition, subparagraph (m), relating to repurchase agreements, should be revised to eliminate the disclosure requirements already required by SFAS 107 and SFAS 115.

- **Eliminate subparagraphs (b) through (h) of Rule 4-10 of Regulation S-X.**

Rules 4-10(b) through (h), setting forth the requirements under the successful efforts accounting method followed by oil and gas producers, are duplicative of SFAS 19. Specific rules for both the successful efforts and full cost accounting methods were maintained in Regulation S-X as a result of the Commission's action to supersede the FASB's determination to designate successful efforts as the method of accounting to be applied uniformly by all oil and gas producers.

- **Eliminate or modify Article 7 of Regulation S-X.**

Article 7, relating to requirements for insurance companies, could be eliminated because the AICPA Industry Guides adequately cover disclosures by insurance companies. However, if Article 7 is deleted, the provisions of Notes 6 to 7-03(a), relating to disclosure of investments in excess of 10 percent of shareholders' equity, should be incorporated into Industry Guide 6.

Alternatively, Rule 7-02(b) could be eliminated because its requirements are covered by SFAS 120 and SOP 95-1.

Any change to Article 7 would require corresponding changes to the EDGAR Financial Data Schedules, which are based in part on information elicited by disclosure requirements in Article 7.

- **Modify Rule 10-01(a) of Regulation S-X.**

Rule 10-01(a) sets forth requirements for condensed financial statements to be filed for interim periods. In 1992, interim reporting requirements were modified for small businesses. In recommending this action, the staff highlighted its potential to be substituted for the current Rule 10-01 (a). Rule 10-01 (a) may now be rewritten to be consistent with the modifications adopted for small business issuers under Regulation S-B. This revision would reduce the degree of detail required and would make the small business modifications applicable to all registrants filing interim reports.

- **Eliminate Staff Accounting Bulletin 43.**

This bulletin provides guidance concerning the early adoption of new rules for separate financial statements required by Regulation S-X. Guidance is no longer necessary due to lapse of time.

- **Eliminate or Modify Staff Accounting Bulletin 50.**

The Task Force recommends below that General Instruction G to Form S-4, relating to the filing and effectiveness of registration statements involving the formation of bank holding companies and requests for confidential treatment, be eliminated. If this instruction is eliminated, the Commission should consider eliminating or modifying SAB 50, which relates to financial statement requirements in filings involving the formation of a bank holding company.

- **Modify Staff Accounting Bulletin 80.**

This bulletin provides guidance relating to the application of Rule 3-05 in initial public offerings. The Task Force recommends that this bulletin be revised to codify previous staff relief granted.

- **Eliminate Staff Accounting Bulletin 86.**

This bulletin provides guidance on accounting for the tax benefits of net operating loss carryforwards that existed as of the date of a quasi-reorganization. The guidance is based on SFAS 96, which subsequently has been amended by

SFAS 109. Eliminating SAB 86 will have the effect of deleting questions 4 and 5 from SAB Topic 5.S. SAB 86 may be eliminated because SFAS 109 contains adequate guidance with respect to the accounting covered by those questions.

- **Eliminate Staff Accounting Bulletin 91.**

This bulletin provides guidance on accounting for income tax benefits of bad debts of thrifts. This guidance is unnecessary because of the issuance of SFAS 109.

- **Eliminate Staff Accounting Bulletin Topic 12.A.4**

This bulletin, which provides guidance in filings by Canadian registrants, is no longer necessary.

- **Eliminate Staff Accounting Bulletin Topic 5.C**

This Bulletin provides guidance on accounting for tax benefits of loss carryforwards and is no longer necessary because of the issuance of SFAS 109.

- **The Commission should consider eliminating or modifying Rule 3A-02 of Regulation S-X, Staff Accounting Bulletin 51, and Staff Accounting Bulletin 84 if the FASB issues new standards on consolidation.**

The FASB has issued an exposure draft of a proposed accounting standard to specify when entities should be included in consolidated financial statements. The comment period expired on January 15, 1996. If the FASB issues new standards on consolidation, Rule 3A-02 of Regulation S-X, SAB 51, and SAB 84 should be reviewed to determine whether they are duplicative of FASB standards and should be deleted or modified.

- **Rescission of Staff Accounting Bulletin 57**

This bulletin provided guidance as to the accounting for stock warrants when issuance is contingent on achievement of certain future events. SAB 57 contained a commitment to revisit that guidance upon completion of a FASB project on accounting for stock compensation and was identified by the Task Force as representing outdated guidance to be included with the Task Force recommendations. FASB Statement 123, Accounting for Stock-Based Compensation includes specific provisions for transactions with non-employees that were effective as of December 15, 1995. Since transactions with non-employees were the transactions covered by SAB 57, the SAB was rescinded as of December 15, 1995.

## **XII. TECHNICAL CHANGES**

This section focuses principally on recommendations that are designed to modernize current disclosure requirements. In addition, several recommendations in this section relate to technical adjustments that the Task Force believes have become appropriate in light of technological advances in communications, or to accommodate other Task Force recommendations.

**Make technical changes to numerous other rules and forms, which in the aggregate should render the Commission's disclosure requirements easier to understand and follow.**

The Task Force recommends making the following changes in order to modernize and make technical modifications to certain rules and forms:

- **Securities Act Rule 153** (Definition of "preceded by a prospectus" as used in Section 5(b)(2), in relation to certain transactions)

If practicable due to availability of a site on the Internet, extend Rule 153 to include delivery for Nasdaq listed companies (unlike an exchange, for which Rule 153 is available, there is no physical place to deliver prospectuses for Nasdaq trades).

- **Securities Act Rule 252** (Regulation A -- Offering statement)

Consider allowing the addition or withdrawal of a delaying notation by facsimile under Rule 252(h)(2).

- **Securities Act Rule 402** (Regulation C -- Number of copies -- binding - signatures)

Modify and clarify that typed, faxed or duplicated signatures are acceptable so long as manual signatures are retained by the company for an appropriate time period. Existing rules applicable to electronic filings and securities offered under employee benefit plans have a five-year retention period.

- **Securities Act Rule 406** (Regulation C -- Confidential treatment of information filed with the Commission)

Clarify that confidential treatment requests must be submitted in paper format only.

- **Securities Act Rule 424** (Regulation C -- Filing of prospectuses -- number of copies)

Consider revising paragraph (d) to permit prospectuses consisting of a radio or television broadcast that must be reduced to writing to be filed no later than the day used rather than five days prior to use.

- **Securities Act Rule 457** (Regulation C -- Computation of fee)

Consider adding a specific reference to spin-offs in Rule 457(f) consistent with the staff's informal guidance that the registrant should look to Rule 451 (f) for guidance when computing the filing fee for a spin-off.

- **Securities Act Rule 471** (Regulation C -- Signatures to amendments)

Modify and clarify that typed, faxed or duplicated signatures are acceptable so long as manual signatures are retained by the company. Existing rules applicable to electronic filings and securities offered under employee benefit plans have a five-year retention period.

- **Securities Act Rule 473** (Regulation C -- Delaying amendment)

Consider revising Rule 473 to allow the filing of the specified amendments by facsimile.

- **Securities Act Rule 503** (Regulation D -- Filing notices of sales)

If Form D and Rule 503 are not eliminated (as recommended above):

Modify and clarify that typed, faxed or duplicated signatures are acceptable so long as manual signatures are retained by the company. Existing rules applicable to electronic filings and securities offered under employee benefit plans have a five-year retention period.

Revise paragraph (c) to state in rule form (rather than requiring an undertaking) that, upon written request of the staff, the issuer must furnish to the Commission the information furnished by the issuer to any purchaser that is not an accredited investor.

- **Securities Act Rule 504** (Regulation D -- Exemption for limited offerings and sales of securities not exceeding \$1,000,000)

Move the exemption relating to information requirements from Rule 502(b) into Rule 504(b).

- **Securities Act Rule 702(T), Rule 703(T) and Form 701** (Notice of sales pursuant to an exemption under Section 701; disqualifying provision relating to an exemption under Section 701; report of sales of securities pursuant to a compensatory benefit plan or contract relating to compensation)

Formally eliminate Rule 702(T), Rule 703(T) and Form 701 so that they will be removed from the Code of Federal Regulations. By their terms, Rules 702(T) and 703(T) (and thus Form 701) were effective only until 1993.

- **Securities Act Rule 902(a)(1)** (Regulation S -- Rules governing offers and sales made outside the U.S. without Securities Act registration)

Update the definition of "a designated offshore securities market" to include markets that have been recognized as such since the adoption of the rule.

- **Exchange Act Rule 3a12-3(b)** (Exemptions from Sections 14(a), (b), (c), (f), and Section 16 for securities of certain foreign issuers)

Make revisions to clarify that foreign issuers may ascertain their status as foreign private issuers at the end of each fiscal quarter and upon the occurrence of specified events.

For purposes of the Section 16 look-back provisions, clarify that a foreign private issuer may disregard the period prior to which it lost its status as a foreign private issuer.

- **Exchange Act Rule 12b-11** (Regulation 12B -- Registration and reporting -- Number of copies -- signatures -- binding)

Modify and clarify that typed, faxed or duplicated signatures are acceptable so long as manual signatures are retained by the company. Existing rules applicable to electronic filings and securities offered under employee benefit plans have a five-year retention period.

- **Exchange Act Rules 13a-13 and 15d-13** (Quarterly Reports on Form 10-Q and Form 10-QSB)

Eliminate subparagraphs (c)(1) and (2) of Rules 13a-13 and 15d-13, which exempt small life and mutual life insurance companies from filing quarterly financial results on Form 10-Q and Form 10-QSB. The exemption for small life insurance companies expired by its terms on December 20, 1983, and the exemption for mutual life companies was meant to track the small life insurance companies exemption.

- **Exchange Act Rule 14d-1** (Scope of and definitions applicable to Regulations 14D and 14E)

Modify and clarify that typed, faxed or duplicated signatures are acceptable so long as manual signatures are retained by the company. Existing rules applicable to electronic filings and securities offered under employee benefit plans have a five-year retention period.

- **Exchange Act Rules 15d-6 and 12h-3** (Suspension of duty to file reports under Section 15(d))

Combine Rule 15d-6 and Rule 12h-3 into one rule located among the rules promulgated pursuant to Section 15(d), so that registrants can look to a single rule for the requirements relating to the suspension of Section 15(d) reporting obligations. Rule 12h-3 would be eliminated as a separate rule.

- **Exchange Act Rule 16a-3** (Reporting transactions and holdings)

Modify and clarify that typed, faxed or duplicated signatures are acceptable so long as manual signatures are retained by the company. Existing rules applicable to electronic filings and securities offered under employee benefit plans have a five-year retention period.

- **Exchange Act Rule 24b-2** (Non-disclosure of information filed with the Commission and with any exchange)

Clarify that confidential treatment requests must be submitted in paper format only.

- **Items 501(b) and (c)(8) of Regulation S-K** (Cross-reference sheet; "Subject to completion" legend)

Eliminate the requirement for a cross-reference sheet under Item 501(b). The requirement under Item 502(g) to include a reasonably detailed table of contents with page numbers, including the location of any risk factors section, is sufficient guidance. If the cross-reference sheet is eliminated, references to it should be deleted from Securities Act Rule 472.

Eliminate the requirement under Item 501(c)(8) to set forth the "Subject to Completion" legend in red ink. Such a revision would conform Regulation S-K to Regulation S-B.

- **Item 509 of Regulation S-K** (Interests of named experts and counsel)

Add an instruction to Item 509 to require that indemnification provisions relating to named experts and counsel be disclosed.

- **Form 1-A** (Regulation A offering statement)

Revise and update the narrative disclosure model for offering circulars and offering statements under Regulation A.

- **Form S-4** (Registration statements to be used under the Securities Act by domestic companies to register securities in a merger or exchange offer)

Consider eliminating General Instruction G to Form S-4, which relates to the filing and effectiveness of registration statements involving the formation of bank holding companies and requests for confidential treatment. This instruction is no longer necessary because Securities Act Section 3(a)(12) provides an exemption for bank holding company reorganizations.

If General Instruction G to Form S-4 is eliminated, references to the instruction should be deleted from Rules 406(a), 464, 473(d), 475a, and 477(b) in Regulation C.

- **Form F-4** (Registration statements to be used under the Securities Act by foreign private issuers to register securities in a merger or exchange offer)

Delete the references in Rules 406(a), 464, 473(d), and 475a of Regulation C to registration statements filed on Form F-4 in compliance with General Instruction F. This reference appears to be in error.

- **Form 8-K** (Current report pursuant to Section 13 or 15(d) of the Exchange Act)

Clarify in Item 2 of Form 8-K that, upon the acquisition of operating real estate, the registrant is considered to have purchased operating properties (as opposed to assets in the ordinary course of business) and Item 7 of Form 8-K and Rule 3-14 of Regulation S-X applies. This would codify current staff interpretations.

- **Form 10-K** (Annual report pursuant to Section 13 or 15(d) of the Exchange Act)

- Eliminate Instruction I which relates to "Registrants Filing on Form S-18," since Form S-18 no longer exists.

- Add an instruction explaining the significance of the market capitalization determination and the manner in which it should be determined. The market

capitalization project has shown that a very large number of companies complete this portion incorrectly. Require a standardized numerical presentation.

- Require a table of contents in lieu of cross references to the items of the form.

- General Instruction J to Form 10-K provides for abbreviated disclosure by certain subsidiaries, subject to certain conditions. The Task Force recommends that these conditions be updated as follows:

- Current rules require the subsidiary to provide a narrative analysis by management. The Task Force recommends updating the provisions to more closely track the current disclosure requirements in Item 303 of Regulation S-K relating to Management's Discussion and Analysis.

- Current rules require that the subsidiary has not had, during the previous 36 months, a material default in any payment of principal, interest, a sinking or purchase fund installment or any other material default, which was not cured within 30 days, or a material default in the payment of rentals under material long-term leases. The Task Force recommends revisions to reduce the applicable time-period to 12 months. This change would conform this requirement in the Form 10-K to the more up-to-date requirements of Forms S-3/F-3.

- **Form 15** (Certification and notice of termination of registration under Section 12(g) of the Exchange Act or suspension of duty to file reports under Sections 13 and 15(d) of the Exchange Act)

Consider parentheticals under each of the boxes on the form so that anyone reading the form will immediately understand why the registrant will no longer be a reporting company.

If the recommendation to merge Exchange Act Rules 12h-3 and 15d-6 is implemented, make appropriate simplifying revisions.

- **Form 18** (Application for registration of securities of foreign governments and political subdivisions thereof)

Update outdated references in this form, such as the reference to the "Statistical Handbook of the League of Nations."

- **Other Revisions**

As a result of the small business initiatives, all references to Forms 10-Q, 10-K and 10 were revised to, where appropriate, also reference the small business

equivalents of those forms, such as Form 10-KSB. However, not all changes were made with the correct conjunction (e.g., "Form 10-K and Form 10-KSB" as opposed to "Form 10-K or Form 10-KSB"). The Task Force recommends that such references be reviewed and corrected.

Change the references in Forms F-7, F-8, F-9, F-10 and F-80 to Rule 24 of the Commission's Rules of Practice to refer instead to Item 10 of Regulation S-K. Rule 24 has been eliminated and its requirements are now set forth in Item 10.

### **XIII. OTHER CURRENT COMMISSION INITIATIVES**

The Commission should consider this Report in conjunction with the many other initiatives currently being undertaken by the Commission to streamline and modernize regulations relating to corporation finance. A brief summary of such initiatives is set forth below.

#### **• Streamlining Disclosure Requirements Relating to Significant Business Acquisitions; Quarterly Reporting of Unregistered Equity Sales**

The Commission proposed new rules designed to streamline the disclosure requirements relating to significant business acquisitions. The proposed rules would eliminate the requirement to provide audited financial statements for certain pending business acquisitions and would generally allow registrants to provide information about significant acquisitions in Securities Act registration statements on the same time schedule as for Exchange Act reporting. The proposed rules also would provide an automatic waiver of the earliest year of required audited financial statements otherwise required in certain cases when they are not readily available. In addition, the Commission proposed rule revisions that would require registrants to report on a quarterly basis recent unregistered sales of equity securities. See Release No. 33-7189 (June 27, 1995).

#### **• Relief from Section 12(g) Registration for Small Issuers**

The Commission proposed to raise the asset threshold that subjects companies to registration under Section 12(g) of the Exchange Act from five million dollars to ten million dollars. The proposals also would raise the asset threshold for termination of Section 12(g) registration and suspension of Section 15(d) reporting from five million dollars to ten million dollars. See Release No. 33-7186 (June 27, 1995).

#### **• Solicitations of Interest Prior to Initial Public Offerings**

The Commission proposed a rule that would allow issuers contemplating initial public offerings to solicit indications of investor interest in their companies prior to the filing of a registration statement under the Securities Act. In addition, if an issuer "tests the waters" under this proposed new rule and decides not to proceed with a registered offering, the issuer may still use Regulation A. See Release No. 33-7188 (June 27, 1995).

In addition, the Commission proposed to amend the "test the waters" provisions under Regulation A to permit issuers that "test the waters" under Regulation A, and then decide to have a registered offering instead, to do so without waiting 30 days. See Release No. 33-7188 (June 27, 1995).

- **Rule 144 -- Holding Period; New Trading Strategies**

The Commission proposed to reduce the holding period required for resales by any person under Rule 144 from two years to one year, and to reduce the holding period for resales by non-affiliates without restriction from three years to two years. See Release No. 33-7187 (June 27, 1995).

In addition, the Commission solicited comment on whether Rule 144 should be revised to address new trading strategies such as equity swaps. See Release No. 33-7187 (June 27, 1995).

- **Exemption for Certain California Limited Issues**

The Commission proposed a new exemption from registration for limited offerings up to five million dollars that meet the qualifications of a new California exemption for offerings made to specified classes of qualified purchasers that are similar to accredited investors under Regulation D. See Release No. 33-7185 (June 27, 1995).

In addition, the Commission solicited comment on whether it should revise or eliminate the prohibition against general solicitation in offerings pursuant to Rules 505 and 506 under Regulation D. See Release No. 33-7185 (June 27, 1995).

- **Problematic Practices Under Regulation S**

The Commission published its views concerning problematic practices under Regulation S and requested comment on whether that Regulation should be amended to limit its vulnerability to abuse. See Release No. 33-7190 (June 27, 1995).

- **Streamlining and Consolidation of Executive and Director Compensation**

The Commission proposed amendments to Item 402 of Regulations S-B and S-K and to Forms 10-K and 10-KSB and Schedule 14A under the Exchange Act. The annual proxy and information statement would be streamlined by allowing some of the more detailed compensation disclosure required by Item 402 of Regulations S-B and S-K to be provided in the annual report on Form 10-K filed with the Commission rather than included in the proxy or information statement furnished to shareholders. The proposals also would affect director compensation disclosure, which would remain in the proxy statement, by consolidating certain elements of that disclosure into an easier-to-read tabular format that provides information for each director. See Release No. 33-7184 (June 27, 1995).

- **Abbreviated Financial Statements**

The Commission proposed amendments to allow the use of abbreviated financial statements in annual reports delivered to shareholders pursuant to the proxy rules. Rule changes also were proposed to allow the use of abbreviated financial statements in other disclosure documents, including prospectuses, required to be delivered to investors. See Release No. 33-7183 (June 27, 1995). Chairman Levitt has announced that further thought is being given to this proposal in light of the public comments, and consideration is being given to whether there are alternatives that may better serve both investors and companies.

- **Section 16 -- Ownership Reports and Trading by Officers, Directors and Principal Security Holders**

In 1994, the Commission issued two releases proposing amendments to certain rules regarding the filing of ownership reports by officers, directors and principal security holders and solicited comment on the Section 16 treatment of cash-only instruments. See Release No. 34-34514 (August 10, 1994) (the "Proposing Release"); Release No. 34-34681 (September 16, 1994) (the "Cash-Only Release"). On October 11, 1995, the Commission proposed an alternative scheme to amend Rule 16b-3 and solicited comment on various other issues relating to Section 16. See Release No. 34-36356 (October 11, 1995) (the "Alternative Proposal Release"). The Alternative Proposal Release proposed a major simplification of Rule 16b-3 to exempt from Section 16(b) most transactions between an officer or director and the issuer. Comment also was solicited on simplifying the reporting of transactions under Section 16(a). The release further proposed greater flexibility for DRIP plans. In addition, the Commission solicited comment as to the continued efficacy of Section 16(b) and whether legislation should be proposed to rescind it.

- **Derivatives Disclosure**

In response to an increasing involvement in derivatives activity by public companies leading to potential exposure to significant risks, the Commission issued interpretive guidance and proposed rule amendments in a release in late 1995. See Release No. 34-36643 (December 28, 1995). The release was intended to (1) enhance disclosures about registrants' accounting policies associated with derivatives and other instruments and (2) increase quantitative and qualitative disclosures by registrants about the market risks inherent in these instruments.

- **Use of Electronic Media**

The Commission is working to facilitate the use of electronic media to enhance communication and save costs. The Commission implemented one of its initiatives in this area in a recent interpretive release that discusses the ability to use electronic delivery of prospectuses and reports to shareholders who have the means to communicate electronically. The interpretive guidance is intended to assist market participants in using electronic media to provide information under the federal securities laws and to encourage continued research and development and use of such media. See Release No. 33-7233 (October 6, 1995). A release also was issued proposing technical amendments to rules premised on paper delivery to make it clear how those rules should be implemented when electronic media are being used. See Release No. 33-7234 (October 6, 1995).

In addition, the Commission has embarked on an effort to make documents and other information available through the Internet. As part of this endeavor, the Commission established a "home page" on the World Wide Web, which offers access to the Commission's EDGAR database of corporate information, SEC News Digests, rule proposals, litigation releases, speeches, testimony, press releases, and other information relating to the Commission, including an electronic copy of this Report. The Commission's World Wide Web address is <http://www.sec.gov>.