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STATEMENT OF HAMER H. BUDGE, CHAIRMAN OF THE SECURITIES AND EXCHANGE
COMMISSION, BEFORE THE SUBCOMMITTEE ON COMMERCE AND FINANCE OF THE
COMMITTEE ON INTERSTATE AND FOREIGN COMMERCE, HOUSE OF REPRESENTATIVES

October 12, 1970

Mr. Chairman and members of the subcommittee, it is a pleasure to be here this morning to present the Commission's views on S. 3431, pertaining to certain amendments to Public Law 90-439, and S. 336, a proposal to increase the Regulation A ceiling under the Securities Act of 1933.

I should like to begin today with a discussion of the amendments to Public Law 90-439, which became law on July 29, 1968.

Public Law 90-439 provides for disclosures with respect to substantial acquisitions of securities registered under the Securities Exchange Act and in connection with tender offers for such securities, together with protections against fraudulent activities. It permits Commission regulation of corporations' purchases of their own shares and provides for disclosure in connection with changes of a majority of the board of directors in conjunction with acquisitions of securities and takeover bids. It also provides for the regulation of solicitations or recommendations to accept or reject the tender offer. Substantive protections for the public investor to whom the tender offer is directed are also provided, such as providing a limited time in which tendered securities can be withdrawn, a limited period during which securities must be taken up on a pro rata basis rather than a first-come, first-serve basis, and

provisions that if the terms of a tender offer are varied by increasing the price the benefits of that increase must be afforded to persons who have already tendered their securities.

Immediately after enactment of the legislation, the Commission adopted regulations pertaining to the form and content of the disclosures to be furnished and related matters. This was done since certain provisions in the legislation were not self-executing. I have a complete set of the pertinent regulations with me today if the committee would like to have them inserted in the record at this point.

Our experience with the operation of Public Law 90-439 has been most satisfactory. The quality of disclosure available to the investing public has been substantially improved in addition to providing important new protections concerning the terms of tender offers. Since the enactment of the legislation through June 1970, filings relating to 103 tender offers and 542 acquisitions of securities have been made with the Commission and made available to the public. The 103 tender offers involved a total of \$2.61 billion. If the committee wishes, I can submit for the record a table showing the names of the companies involved in the 103 tender invitations, as well as the dates and dollar amounts involved.

After this brief sketch, I now would like to turn to the specific amendments pending before you in S. 3431. The first section of the bill would amend in two respects Section 13(d)(1) of Public Law 90-439, which section requires any person who acquires ten percent or more of equity

securities registered under the Securities Exchange Act or any equity securities issued by a registered closed-end investment company to file with the Commission certain specified disclosures. These would include, for example, disclosures pertaining to the identity and background of the person who acquired such securities, the source and the amount of funds to be used, and the purposes for which the shares were acquired.

The first amendment to Section 13(d)(1) would be to extend its coverage to insurance companies. The present law applies only to securities registered pursuant to Section 12 of the Securities Exchange Act and to registered closed-end investment companies. The securities of insurance companies are not so registered by reason of the exemption contained in Section 12g(2)(G) of the Securities Exchange Act for insurance company securities which are subject to specified state regulation.

The Commission, of course, does not wish to disturb the Congressional decision reached in 1964 to leave reporting, proxy solicitation and the regulation of insider trading with respect to the securities of insurance companies to appropriate state authorities. As I indicated in my testimony before The Senate Subcommittee on Securities last March, it may well be that the considerations which resulted in leaving this latter type of regulation to the states may be inapplicable to tender offers. More frequent than not, tender offers are made on a nationwide basis and are not presently regulated by state insurance commissioners. Indeed, it might be quite difficult for a state commissioner to regulate a tender offer made

from outside his state. While we do not know precisely the number of insurance companies to which the amendment would extend, we have information showing that for the calendar years 1967 to 1969, 15 tender offers were made for shares issued by national insurance companies. I have this list with me today if you would like it to be included in the record.

The second change in S. 3431, as it relates to Section 13(d)(1), would be to reduce the ten percent figure in that section to five percent. This would mean that the provisions of present law would be triggered at the five percent level instead of the present ten percent level. The principal reason this change would be appropriate is that there is evidence that companies undertaking an acquisition, limit their prior purchases of stock in the open market to around nine percent as a means of avoiding making disclosures to the investing public. Obviously, ten percent of the securities of the larger corporations represents very large amounts of money.

S. 3431 would also amend Section 13(e) of the Securities Exchange Act of 1934. This section authorizes the Commission to adopt rules and regulations with respect to purchases by certain issuers of their own securities. Subsection (e)(2) provides that a purchase by or for a person in a control relationship with the issuer, or a purchase by a person on behalf of the issuer is considered to be a purchase by the issuer for the purpose of the subsection. The present proposal provides the authority of the Commission to adopt such rules and regulations as may be appropriate. It seems unnecessary to place on persons in a control relationship with the

issuer all of the requirements, such as notice to shareholders and other restrictions, which may be appropriate for purchases by the issuer of its security.

Section 14(d), which was likewise added by Public Law 90-439, makes it unlawful to make a cash tender offer for securities subject to these provisions without filing with the Commission a statement containing essentially the same information as is provided for in Section 13(d) and furnishing such part of this information as the Commission may require to security holders who are invited to tender their shares. Section 14(d) also contains provisions governing the terms of a cash tender offer.

The present bill, S. 3431, would eliminate the exemption contained in Section 14(d) for exchange offers of securities registered under the Securities Act of 1933. The exchange offer is a situation where instead of offering cash for the securities of the target company, securities of the acquiring company are offered.

While registration under the Securities Act provides for disclosure and thus is an adequate substitute for the disclosures required by Section 14(d), the substantive provisions of the statute as they relate to the terms of the cash tender are not applicable to exchange offers of securities nor does the statute at present provide for regulation of solicitations in opposition to such an exchange offer.

Our information shows that from the effective date of the bill through December 31, 1969, offerings of securities in exchange for other securities in the approximate aggregate amount of \$18 billion were regis-

tered with the Commission. These offerings which are exempt from most of the provisions of the law, exceeded in number and in dollar amount the cash tender offers which are subject to existing law. We have noticed a tendency to use exchange offers when an attempt is made to take over large corporations which would be extremely difficult to finance by means of a cash tender offer. S. 3431, if enacted, would have the desirable result of extending the substantive and other protections of Public Law 90-439 to the larger group of public security holders to whom such offers are made.

The final amendment contained in S. 3431 would be to Section 14(e). Existing Section 14(e) prohibits false statements and fraudulent or deceptive practices in connection with tender offers, but it does not grant the Commission any rule-making authority to deal with such practices. Section 5 of S. 3431 would add a sentence granting to the Commission rule-making power to define and prescribe means reasonably designed to prevent fraudulent, deceptive and manipulative practices. The language in this amendment is identical with that contained in existing Section 15(c)(2) of the Exchange Act, which grants the Commission rule-making power with respect to fraudulent, deceptive or manipulative practices by brokers and dealers in transactions in the over-the-counter markets. The rule-making power provided for by Section 5 of the bill would enable the Commission to deal more effectively with the devices sometimes employed on both sides in contested offers.

For the foregoing reasons the Commission strongly supports the proposal to amend Public Law 90-439.

I understand that today's hearing, insofar as it involves proposed amendments to the take-over bid law, relates not only to S. 3431, to which my testimony has thus far been directed, but also to H.R. 4285. This latter bill was introduced in the House of Representatives by Congressman Monagan and referred to your Committee on January 23, 1969, over a year before S. 3431 was introduced in the Senate. I note, however, that it would amend the take-over law in only one respect. It would require that a party attempting to take over should give the Commission and the issuer (the target company) 30 days notice. In contrast with this single purpose, S. 3431 provides a comprehensive pattern of changes in the take-over law in five respects, all of which seem to be called for by our experience in administering that law since it was enacted in July of 1968. The Commission accordingly suggests that H.R. 4285 should not be reported out as against S. 3431, the enactment of which the Commission strongly favors.

S. 336: A Proposal to Permit an Exemption of Security Issues
Not Exceeding \$500,000 from Certain Provisions

S. 336 would amend Section 3(b) of the Securities Act of 1933 so as to increase the maximum aggregate amount of securities of certain issuers offered to the public, which may be exempted from registration under the Act pursuant to rules and regulations of the Securities and Exchange Commission, from \$300,000 to \$500,000. The Commission supports this amendment, and if it is enacted the Commission will act promptly to consider what amendments to its rules and regulations are necessary to give effect to the intent of Congress. A pressing purpose of S. 336 is to aid small businesses in raising capital, and the regulation primarily affected will be the Commission's Regulation A.

At this point, I believe it would be helpful to explain the effect of S. 336 in the context of the general provisions of the Securities Act. The Act, as you know, requires that companies proposing to make public offerings of securities file registration statements covering those securities with the Commission, unless the statute provides an exemption. Section 3(b) of the Act authorizes the Commission by appropriate rules and regulations to provide such an exemption for offerings not exceeding a specified dollar amount. This dollar amount was set at \$100,000 in 1933 and a 1945 amendment to the Securities Act increased the amount to \$300,000. Section 3(b) still contains the \$300,000 figure today, 25 years later.

The legislative history of the 1945 amendment indicates that the primary reason for the increase then was the desire of Congress to aid

small businesses in raising necessary capital for the commencement or expansion of business, and it considered that \$100,000 would, in many cases, be an inadequate amount for the accomplishment of such objectives in view of generally increased costs as compared to those existing when the Act was passed in 1933.

An identical situation exists at the present time. Costs have continued to rise throughout the economy with the result that the \$300,000 of 1945 has substantially less purchasing power today. In many cases, it is an inadequate amount to finance properly either a small established business seeking to modernize or expand, or a newly organized venture requiring a substantial amount of seed capital. It would take substantially more dollars now to purchase the same amount of capital goods which could have been bought in 1945 for \$300,000. One purpose of S. 336, then, is simply to update Section 3(b) so that the original policy underlying that section will be carried out in present-day economic conditions.

Current economic conditions also present other problems for a company desiring to raise \$300,000 or less through the vehicle of a Regulation A offering. The \$300,000 limitation makes it difficult for issuers to interest investment bankers in such offerings because the larger and more experienced investment banking houses are not interested in underwriting small issues, partly because returns to them would not be commensurate with the effort needed to underwrite such an offering. Where an underwriter can be found, the underwriting commissions for small issues may run as high as 15% to 20% of the

amount sold which, of course, reduces the funds available to the issuer of the securities. The problems facing a small company in obtaining financing may be considerable because such sources as banks and private investors may not be willing or able to provide adequate risk capital. A public offering may therefore be the only viable alternative source of financing, whatever the cost.

This explains, then, why members of Congress and the financial community have suggested the desirability of a further increase in the \$300,000 limitation. I might mention in passing that this is not the first time such a proposal has been before the Congress. When the Securities Act was amended in 1954, the bill which passed the Senate would have raised the limitation to \$500,000. However, no such provision was included in the bill which passed the House of Representatives. When the differences in the two versions were submitted to conference, the Conference Committee declined to accept the Senate version of the bill in this respect, and it was the Conference Committee's version which was enacted into law.

At the beginning of my comments on this bill, I mentioned that Section 3(b) authorizes the Commission to promulgate rules and regulations to give effect to the exemption provided by that section. Several such rules and regulations have been adopted, namely, Rules 234, 235 and 236 and Regulations A and F. I have copies of these rules and regulations if you wish to include them in the record. They provide exemptions for first lien notes, securities of cooperative housing corporations and assessments on assessable stock, and

exemptions for certain other securities.

For purposes of S. 336, the most relevant exemption is that provided by Regulation A. Regulation A presently permits a company to obtain needed capital not in excess of \$300,000, including underwriting commissions, in any one year, from a public offering of its securities without registration, provided specified conditions are met. These include the filing of a notification supplying basic information about the company and the filing and use in the offering of an offering circular. These documents are somewhat simpler to prepare and less expensive to print than the full registration statement required under the Securities Act for nonexempt offerings. It will be necessary for the Commission to amend Regulation A to give effect to the wishes of Congress if it enacts S. 336 into law. The Commission will consider such an amendment promptly after enactment of the bill.

Gentlemen, this concludes my comments on these two bills. I will be happy to answer any questions you may have.