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SELECTED CURRENT ISSUES IN SECURITIES REGULATION

ADDRESS BY

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I am happy to be with you this morning at the opening of this conference on securities regulation. The wide range of subjects scheduled for discussion is an indication that significant changes are occurring, and the interaction and discussion at meetings such as this can assist both the Commission and the private sector to better shape and understand these changes.

It would be impossible for me to include in my remarks all of the issues that will be considered during this conference, but I would like to set the stage for the panels which will appear today and tomorrow by commenting on four of the areas which will be discussed. Small business policy, tender offer regulation, management reports on internal accounting controls, and corporate governance are all matters in which the Commission has recently taken major action and where further action is contemplated.

The first topic of the conference is Recent Developments in Capital Formation. It has been said that the Commission's interest in the functioning of our capital markets is of recent origin and that prior to the Securities Acts Amendments of 1975 we functioned almost exclusively as an enforcement agency to protect investors. Investor protection in the broad sense is the Commission's primary mission but I can assure you from personal experience that

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at least since 1973 the functioning of our capital markets has been an important consideration. Moreover, in my opinion it was part of the purpose for which the Commission was established in 1934 and has had an impact on Commission decision-making from the very beginning.

The legislative history of the Securities Act of 1933 ("1933 Act") and the Securities Exchange Act of 1934 ("1934 Act") makes clear that the purpose of these statutes was to support this country's economy by facilitating the raising of capital through a restoration of investor confidence in the integrity of our capital markets. The principle means through which this was to be achieved was full and fair disclosure. The implementation of this objective requires that the benefits of disclosure to investors and the public exceed its costs and as the designated administrative regulatory agency, the SEC has a continuing responsibility to see that benefits and burdens are appropriately balanced.

In 1978, prompted by increasing government and public concern that government regulation was adversely affecting small businesses, the Commission undertook a formal reevaluation of the benefits and the burdens resulting from the registration and reporting requirements on small companies. We issued releases requesting public comment and held hearings on a number of questions relating to the impact of the 1933 and 1934 Acts on small business and the Commission concluded that it should be possible to reduce or to eliminate some burdens without sacrificing investor protection.

To this end the Commission established the Office of Small Business Policy and during the past year has enhanced the ability of small businesses to raise capital by the adoption of Form S-18, a shortened form for the registration of up to $5,000,000 worth of securities, the raising of the ceiling on the dollar amount of securities which can be sold pursuant to Regulation A from $500,000 to $1,500,000, and a reduction in the restrictions imposed by Rule 144 on the resale of unregistered securities.

There are also several other potentially far-reaching initiatives underway or under serious consideration. In September the Commission proposed for comment Rule 242 which would allow certain corporate issuers to offer and sell up to $2,000,000 per issue of their securities to an unlimited number of "accredited" purchasers and to thirty-five other purchasers. Accredited purchasers generally include regulated institutions or entities advised by such institutions, and persons who buy $100,000 or more of the issuer's securities sold in reliance on the rule and pay for them in cash or cash-equivalent. Issuers would be required to furnish the same kind of information specified in Part I of Form S-18 to those purchasers who are "non-accredited," and meet certain other conditions.

The rule was proposed in response to commentators who suggested that Rule 146 is not very helpful to small businesses because it requires issuers to make a subjective determination concerning the sophistication of each offeree and each purchaser

and because there was uncertainty as to the required disclosure by issuers who did not file reports with the Commission. Rule 240 was also viewed as inadequate because, although it does not contain offeree or purchaser sophistication requirements or a mandated disclosure requirement, its use is limited to raising $100,000 in any 12-month period and is available only if the issuer has fewer than 100 beneficial owners. Proposed Rule 242 addresses these problems by establishing a $2,000,000 ceiling, by specifying the information which must be provided to offerees and purchasers, and by not including any sophistication requirement.

Comments received on the rule have been favorable, and some commentators have suggested that it be made available to limited partnerships as well as to corporations. Early next year, I expect the staff to recommend that the rule be adopted. If the rule is adopted, and appears to work effectively, it may be appropriate to propose conforming amendments to Rule 146, such as incorporating an express materiality standard with respect to the information which must be received by, or be accessible to, each offeree or his representative or excluding defined institutional investors from the 35 purchaser limitation contained in Rule 146.

There are a number of other projects under serious consideration which the staff may recommend that the Commission publish for comment.

One of them is that the Commission amend Form S-3--the 1933 Act registration form for start-up companies engaged primarily in mining activities--to make it similar to Form S-18, including the Form S-18 $5,000,000 offering ceiling, and permit it to be filed in the regional offices.

There is also an attempt to develop an S-16 type wraparound prospectus for offerings up to a certain dollar size--perhaps $5,000,000, for use by smaller companies which are subject to the continuous reporting requirements of Section 12 or Section 15(d) of the 1934 Act. Although this idea is conceptually similar to Form S-16, the wraparound prospectus for smaller companies actually would be wrapped around certain 1934 reports which a registration statement on Form S-16 simply incorporates by reference. The recent Snowmass Small Business Securities Conference sponsored by the Small Business Committee and Federal Regulation of Securities Committee of the ABA Section of Corporation, Banking and Business Law tentatively endorsed a similar proposal. The wraparound prospectus concept could materialize as a new registration statement or as an adjunct of Regulation A.

Potentially one of the most far reaching proposals being developed by the Office of Small Business Policy is the classification of issuers according to objective criteria for purposes of reducing Exchange Act continuous reporting requirements for small companies. This was recommended by our Advisory Committe on Corporate Disclosure, and was

endorsed by a substantial majority of the witnesses and commentators at the Small Business Hearings. Perhaps the most difficult question presented is the establishment of classification criteria. The Commission's Directorate of Economic and Policy Research is developing a profile of reporting companies by, among other things, size of assets, earnings, number of employees and security holders, and market capitalization. With this empirical data the Small Business Office will attempt to establish issuer classifications requiring degrees of disclosure appropriate to the amount of investor interest involved and the cost of providing the information.

In the first phase of this classification project, the staff will decide whether to recommend that the Commission adopt a rule to raise the Section 12(g) $1 million reporting threshold adopted by Congress in 1964. The new ceiling under consideration is $2.5 million. In conjunction with this, the Commission could adopt a new form requiring issuers who cross the $1 million threshold to file some form of basic data document which would let the Commission know their identity and location.

As a former small businessman, I consider the Commission's actions in the area of small business policy to be most important. Because of the contributions to our country's economy made by small business entrepreneurs and the detrimental effects which result from limiting the ability of small companies to obtain capital from the public, you

can expect a continuing effort to reduce their reporting burdens. Although I have emphasized our actions for small companies, the Commission is attempting to reduce the regulatory burden on all companies subject to its jurisdiction. Just yesterday the Division of Corporation Finance announced a five to seven year program to review all of the rules and regulations it administers with the purpose of improving them and making them less burdensome.

The regulation of tender offers is another subject with respect to which the Commission has been very active. One week ago today we issued Exchange Act Releases 6158 and 6159. The former announces adoption of comprehensive regulations for tender offers and the latter proposes for public comment a definition of the term "tender offer" and three additional rules intended to address the questions of equal treatment of security holders, purchases proximate to but outside the tender offer, and trading on the basis of material non-public information. I expect the panelists to discuss these rules in much more detail, but I would like to say a few words about our actions last week.

Tender offers have been the subject of rule-making at the Commission for almost four years, a period of time which reflects the very difficult questions presented. We have been guided in our actions by the major Williams Act policy goal of securing necessary investor protections without tipping the balance of regulation between the subject company and the bidder.

There may be disagreement with the Commission's judgment in implementing this policy, but we have gone to considerable effort to balance competing interests, including a study by our Directorate of Economic and Policy Research of 153 cash tender offers for common stock listed on the New York or American Stock Exchanges during the period from 1974 through 1978.

One of the key provisions we adopted is Rule 14e-1, which regulates the minimum length of a tender offer. The rule requires that all tender offers--other than certain issuer tender offers--remain open for a minimum of twenty business days from the date of commencement and for ten business days from the date of any notice of increase in the offered consideration or the dealer's soliciting fee. These time periods operate concurrently. Thus, if a bidder increases the consideration on the 8th business day after the commencement of a tender offer, the ten business day period would expire during the minimum twenty day period but if the consideration was increased on the 15th business day after commencement, the minimum would extend to 25 business days.

The purpose of a minimum period is to prevent shareholders from being forced to make decisions quickly on the basis of inadequate or incomplete information. This is an important objective but a requirement that a tender offer remain open for a minimum period can effect the balance between the bidder and subject company. The longer an offer remains open, the more likely it is that the subject company can defeat

it and the more expensive the tender offer becomes for the bidder. Originally the Commission proposed a minimum period of thirty business days. Based on comments received and our own analyses, we determined that a 20 business day minimum is appropriate.

The second tender offer issue which is worthy of your consideration at this conference is our proposed definition of a tender offer. For a number of years the Commission has declined to define the term "tender offer." While we have been sensitive to the need of practitioners and their clients for certainty so they can plan business transactions with some degree of assurance as to the anticipated consequences, it has been our position that this is outweighed by the Commission's need for flexibility in responding to the creativity of those seeking to circumvent the purposes of the Williams Act. We have also been concerned that in order to reach unusual transactions any definition we might propose would have to be so broad as to inhibit normal market activity.

Recently, however, certain business transactions which appear to have been structured to evade the Williams Act but which the Commission viewed as tender offers have caused us to develop the proposed definition in Release No. 6159. Our proposed definition is two-pronged. If a transaction meets the conditions in either prong it would be deemed a tender offer and Regulations 14D and 14E would be applicable. Under the first prong (with the one exception of certain specified open market purchases), a transaction is deemed a

tender offer if during a 45 day period there is directed to more than ten persons, one or more offers to purchase or solicitations of offers to sell more than five percent of a single class of securities.

The second prong of the proposed definition would deem a transaction to be a tender offer if one or more offers to purchase, or solicitations of offers to sell securities of a single class are disseminated in a widespread manner, at a price representing a premium in excess of the greater of five percent of or $2 above the current market, without a meaningful opportunity to negotiate price and terms.

These proposed definitions were developed after a careful analysis of the Williams Act and its legislative history, case law, commission enforcement actions, legal commentary and the Commission's understanding of tender offer and other market transactions. These proposals represent a responsible effort and I hope that those who may agree, disagree, or have recommendations for amendments, will take the time to give us comments before February 1, 1980, when the comment period on these proposals expires. In the meantime, an exchange of views on these proposals at this conference would be valuable.

Another conference discussion issue about which corporate officials have expressed unusual concern is how the Commission intends to administer those provisions of the Foreign Corrupt Practices Act ("FCPA") for which it is responsible. This is evidenced by the more than 950 letters

of comment received in response to our April proposal to require a management report on internal controls. Although some commentators supported the concept of a required management report, most were critical of the proposal.

We proposed that after December 15, 1979, management be required to report its opinion whether as of the date of the balance sheet, the systems of internal accouting control of the registrant and its subsidiaries provided reasonable assurances that certain identified objectives of internal accounting control were achieved. Also, if there were any material weaknesses in internal accounting control communicated by the independent accountants to management which had not been corrected, management would be required to describe those weaknesses and provide a statement of the reasons they remained uncorrected.

In a second stage, for periods ending after December 15, 1980, we proposed that the management report include management's opinion as to whether during such periods the internal control system provided reasonable assurances that the objectives of internal control were achieved and that the management report be examined and reported on by an independent public accountant.

The greatest opposition to the proposal was based on the perception that as drafted, it required a statement of compliance with the FCPA. The proposal was also opposed for requiring disclosure of weaknesses which had been corrected and for not being limited to material information.

The requirement that independent accountants examine and report on the management statement was also severely criticized. More than 500 respondents claimed that such a requirement would not be cost effective because a duplicative review would not add significantly to the auditor's knowledge of the systems of internal controls based on his existing responsibilities. Cost estimates for the proposed auditor review ranged from one percent to three hundred percent of the current audit fee, with an average falling in the range of five to twenty-five percent. Many commentators suggested that it would be appropriate for the Commission to wait until the profession develops standards for reporting on internal control as the AICPA's Auditing Standards Board has undertaken to do.

These adverse comments have caused the staff and the Commission to reconsider the approach the Commission should take to the management report. I believe we were all surprised by the degree of opposition because the proposed rule was intended to implement the concept of a management report to shareholders that had been endorsed by the Cohen Commission, the Financial Executives Institute, and the Special Advisory Committee on Reports by Management of the American Institute of Certified Public Accountants.

Although the Commission considered adopting standards of internal control, this was rejected as being rigid and impracticable. The management report seemed to be a more moderate disclosure approach that would give investors

meaningful information upon which to base an evaluation of the internal controls in their company. In view of the negative commentary on the proposal, however, I do not expect the Commission to adopt the rule as proposed. There are several alternative courses of action under consideration.

It is possible that we could simply withdraw the rule. Over 250 commentators sugested that because of the substantial voluntary initiatives since the enactment of the FCPA, the private sector should be given time to experiment and develop a meaningful management report on internal controls.

We could also adopt a rule for a temporary period of time in order to maintain some momentum toward the development of more comprehensive reporting requirements on internal controls, while giving the Commission time to evaluate what the next step should be. For example, management might be required to disclose significant efforts, if any, that the company has made during the past year to enhance the effectiveness of its system of internal controls. Some staff members believe that such a requirement would help shareholders to understand what companies are doing in response to the FCPA, as well as indicate that compliance with the Act requires a continual monitoring to reflect the dynamic nature of internal controls. As currently being discussed, this alternative would not require management to express an opinion as to whether its internal control system complies with standards of the Act, although such an assessment might be encouraged on a voluntary basis.

I expect the independent accountant's involvement with the management report to be more limited than originally proposed. Some staff members are considering a recommendation that the independent auditor be required to report on whether in the course of the audit, anything came to his attention that was inconsistent with management's report. Under this approach the scope of the audit would not need to be extended.

Other staff members have tentatively concluded that the Commission should require full auditor review of the system of internal accounting controls and disclosure of the auditor's opinion as to its adequacy and whether it is being properly implemented. Such a report would not be required for several years in order to give reporting companies additional time to design and implement their control systems.

I do not expect the Commission to accept the recommendation of some 349 commentators that a materiality standard be incorporated into the rule proposal for disclosure purposes. Congress determined not to include the materiality concept in the FCPA, and for the Commission to engraft it now through a management report requirement could obfuscate that point. Moreover, it might lessen the sensitivity of all of us to what the Act requires.

As the Commission announced last week, any rule adopted pursuant to our proposal will not be effective until sometime next year and no matter what we do with the April proposal, I am sure that the Commission will be revisiting this subject as experience is gained with systems

of internal control, and as the AICPA's Auditing Standards Board develops standards for reports on such controls.

The final subject which I would like to discuss is corporate governance. On November 23 the Commmission adopted rules requiring that shareholders be provided with a form of proxy which indicates whether it is solicited on behalf of the issuer's board of directors, permits shareholders to withhold authority to vote for each nominee for election as a director (or to vote against in those jurisdictions so permitting), and provides a means for shareholders to abstain from matters as to which they have an opportunity to vote. A related amendment requires that if five percent or more of the shares voted are voted against any incumbent director, the company must disclose the results of the voting either in a post-meeting report or in the next proxy statement. It is the Commission's belief that these amendments should make the corporate governance process more meaningful by providing shareholders a greater opportunity to express themselves on the matters with respect to which their proxy is solicited.

Although some commentators suggested that these amendments were being proposed without any evidence that investors were dissatisfied with the way corporations are currently governed, as the Commission indicated in the adopting release, "the absence of pervasive compliants by shareholders does not necessarily mean that the system of shareholder participation is functioning adequately or could not be improved without imposing excessive costs." It may be that

shareholder participation is so limited because shareholders do not believe they have any effective avenue through which to make their views known. There are members of Congress and others who argue that there is no effective governance of corporate management, by directors or shareholders. Perhaps providing shareholders the opportunity to make their views known with respect to a particular candidate for the board or with respect to other corporate issues combined with the additional disclosures that have been required will encourage more active and more effective shareholder participation.

The next step in the Commission's two and one-half year old corporate governance project will be the issuance of a staff report based on the lengthy record this inquiry has developed. This is projected for completion next spring. Then the Commission will have to decide whether it should consider other suggestions to increase the opportunity for shareholder participation such as permitting shareholders to nominate candidates for the board or whether it should refrain from engaging in additional rule-making in the corporate governance area until we see the effect of the actions we have taken to date. I believe it would be unfortunate to add additional burdens on corporations if shareholders are not interested in using the opportunities provided. We will need input from all participants in the corporate governance process to help us make the correct decision.

I hope that my remarks this morning have illustrated the range and complexity of current securities issues. The discussion of such important matters by the panelists and participants at this conference should be lively, provacative, and informative. I look forward to participating in those discussions, as I am sure you do and expect that they will be beneficial to all of us.