



Report to the President of the United States

on

**Regulatory Reform Initiatives of the
Securities and Exchange Commission**



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U.S. Securities and Exchange Commission
April 28, 1992



E CHAIRMAN

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

April 28, 1992

The President
The White House
Washington, D.C. 20500

Dear Mr. President:

On behalf of the Securities and Exchange Commission, I am pleased to submit our Report on Regulatory Reform Initiatives that we have prepared pursuant to your request of January 28, 1992.

The Report identifies 80 reforms of regulations under statutes subject to the Commission's jurisdiction. These reforms relate to the issuance of securities, disclosure of information by publicly traded corporations, the organization and operation of mutual funds and the operation and oversight of the securities markets. Many of these reforms have already been initiated (and some in fact have been completed) since January 28. The remainder are under study by the Commission's staff and, we anticipate, will be proposed in the near future.

We estimate that these reforms will benefit our Nation's economy from both regulatory cost savings and increased efficiency. Importantly, these reforms will not compromise the concerns for investor protection and safety that have helped to make the United States securities markets the largest and most dynamic in the world.

We appreciate the opportunity to submit this summary of our recent review. This is a welcome opportunity to demonstrate the Commission's ongoing commitment to minimize the burdens that we ask others to bear in relation to the benefits produced. We salute your leadership in raising the Nation's awareness to this important, unceasing obligation of all Government agencies.

Yours respectfully,

A handwritten signature in black ink, appearing to read "Richard C. Breeden", with a long horizontal flourish extending to the right.

Richard C. Breeden
Chairman

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INTRODUCTION AND SUMMARY OF MAJOR INITIATIVES

The Securities and Exchange Commission administers the laws governing one of the largest and most important sectors of our national economy -- the United States securities markets. Fundamental to the SEC's role is its mandate to protect investors against fraud and misconduct, to ensure the fairness and stability of the securities markets, and to oversee the efficient operation of the nation's capital-raising activities. The federal securities laws rely heavily on principles of informed investor choice, professional self-regulation and other market oriented solutions in their regulatory approach.

By any measure, the system of regulation embodied in the federal securities laws has been enormously successful. During the past six decades, the U.S. capital markets, and the economy as a whole, have experienced phenomenal growth. Today, the capital markets provide the principal funding mechanism for the operation and growth of U.S. businesses, with all securities traded in the U.S. capital markets approaching \$12 trillion in value. Public participation in these markets has also grown dramatically. In the equity market alone, more than 50 million individuals - 21% of the population -- own securities either directly or through stock mutual funds, giving the United States, by far, the highest participation in its securities markets of any major industrial nation. The U.S. capital markets are the envy of the world for their depth, liquidity, and fairness.

Effective regulation of the capital markets must continue to encourage growth and innovation, while protecting investors. As the year 2000 approaches, the United States must be ready to meet the challenges presented by a changing marketplace in order to maintain the leadership of its markets. The growth in the volume and complexity of securities transactions, the proliferation of new derivative products, the increasing role of institutional investors, the rapidity of technological advances, and

the growth in the international flow of capital are only some of the recent challenges the Commission has faced. This Report demonstrates the Commission's commitment to adapt its regulatory programs to an evolving economic and marketplace environment.

The Report identifies 80 proposals for improvement of regulations under the federal securities laws, proposals that will affect every major regulatory program administered by the Commission. These measures will help make U.S. capital markets even stronger and more efficient by eliminating unnecessary burdens on securities offerings, the markets, and market professionals. They will help facilitate debt and equity financing for businesses, expand investment opportunities for investors, lower regulatory costs, and promote greater economic efficiency. Equally important, these reforms will not impair the fundamental goals of investor protection and confidence that have made U.S. capital markets the best in the world.

SUMMARY OF MAJOR INITIATIVES

Assisting Small Business

Small businesses are at the heart of the U.S. economy. They provide the bulk of jobs to U.S. workers and are the seed bed from which the large industries of the future will grow. On March 12, 1992, the Commission announced a comprehensive package of initiatives to help small businesses raise capital and to reduce their reporting burdens. The specific proposals included the following:

- Regulation A Offerings. The Commission proposed amendments to Regulation A, which provides a less costly process for offering securities. The proposed revisions would reduce the cost of such offerings by (1) raising the annual dollar limit on offerings from \$1.5 million to \$5 million, (2) permitting the use of a simple question and answer format for the offering circular, and (3) permitting companies for the first time to "test the waters" regarding investor interest before incurring the expense of preparing offering documents. These changes will make it easier for small businesses to raise greater amounts of capital without incurring substantial legal and accounting expenses.
- Seed Capital Offerings. The Commission proposed to permit small companies to issue up to \$1 million in securities without any regulatory conditions in a 12-month period. This exemption would be available to any nonreporting company.
- Small Debt Offerings. The Commission proposed to expand exemptions from compliance with certain conditions that apply to issuance of corporate debt securities. The proposal would exempt debt offerings under Regulation A, and allow an issuer to raise up to an additional \$5 million annually without becoming subject to the Trust Indenture Act.
- Simplified Disclosure Requirements. The Commission proposed new, simplified disclosure requirements for registration of securities offerings by small businesses, and for annual and periodic reports filed by small businesses, including a proposed simplified Form SB-1 and 10K "junior" form.
- Small Business Investment Companies. The Commission proposed rules to increase the dollar amount of securities that may be raised without registration by certain types of investment companies that specialize in small business investments.
- Emerging Company Marketplace. On March 5, 1992, the Commission approved an American Stock Exchange rule proposal to create an Emerging Company Marketplace ("ECM"), designed to accommodate the listing of smaller companies. By allowing certain small companies access to an auction market, the ECM should enhance capital raising

potential for these companies and provide greater liquidity to their shareholders. The ECM began trading on March 18.

Lowering Capital Raising Costs and Streamlining Reporting Requirements

In order for U.S. business to remain competitive in an increasingly international economy, it must be able to raise and allocate capital in cost effective and efficient ways, free from the burden of unnecessary regulations that do not add significantly to investor protection. Over the last decade the Commission has undertaken far-reaching regulatory initiatives to facilitate capital raising and to simplify disclosure required under the securities laws. The Commission is continuing to take steps that will reduce costs for securities issuers and make it easier for investors to understand disclosure documents. Among the most significant developments are:

- **Expanded Use of "Shelf" Registration.** Under the existing system of "shelf" registration, securities can be registered for delayed offering, which eliminates the need for further Commission review and provides issuers with greater flexibility in the timing, manner and size of distributions. The Commission will soon consider proposals to make the streamlined "shelf" registration process available for all types of investment grade asset-backed securities and more useful for equity securities.
- **Increasing Use of Rule 144A.** In 1990, the Commission adopted a new rule, Rule 144A, that provides a safe harbor from registration requirements for resales of securities exclusively to large institutional purchasers. The Commission will be considering a proposal to expand the use of Rule 144A to recognize additional types of institutions as qualified institutional buyers. Expanding this market would increase demand and trading liquidity, which should in turn reduce the costs borne by issuers, intermediaries and investors in private offerings.
- **Expanded Eligibility for Form S-3.** The Commission will consider a proposal to expand the eligibility for use of Form S-3 for registration of securities offerings to the public. This would extend to a broader class of issuers the benefits of the Form, which reduces costs by allowing full reliance on Exchange Act reports to satisfy registration disclosure requirements about the issuer and its management.
- **Streamlined Requirements for Insider Reporting.** The Commission will be considering steps to reduce the complexity of the rules under Section 16 of the Securities Exchange Act, which governs reporting of securities transactions by officers, directors, and 10% beneficial owners, and allows the issuer to recover profits made by those shareholders from certain stock transactions within a six-month period.

Facilitating Shareholder Communication and Disclosure of Executive Compensation

The ability of shareholders to influence the decisionmaking of public company officers and directors as well as related concerns over compensation paid to those officers have emerged as important elements of investor confidence. The Commission has proposed or has under consideration a number of steps to make disclosure with respect to these matters both more meaningful for investors and less burdensome for issuers, including:

- **Proxy Reform.** The Commission has published proposals to amend the proxy rules to facilitate shareholder communications and reduce the costs of compliance, and will be revising these proposals shortly in response to public comment.
- **Executive Compensation.** The Commission will also act on proposals to streamline requirements relating to disclosure of executive compensation and replace the current format with one that highlights key information.

Modernizing Investment Company Regulation

Investment companies and mutual funds have become the primary means by which millions of individual Americans invest for the future. In recent years, the Commission has acted to modernize and streamline the existing system of investment company regulation. A comprehensive two-year study of the Investment Company Act has resulted in numerous proposals for change, including the following:

- **Removing Constraints on Asset-Backed Financing.** The Commission will consider new rules under the Investment Company Act exempting certain asset-backed securities from registration under the Act. These rules will remove unnecessary regulatory constraints, expand the markets for asset-backed securities, and should make raising capital easier for all businesses.
- **Creating New Types of Investment Companies.** Certain provisions under the Investment Company Act impose practical limitations on the ability of many forms of investment company to invest significantly in certain securities. These limitations affect investment company interest in securities of small businesses, because these securities can be somewhat illiquid. The Commission will soon consider new exemptive rules to facilitate development of investment companies that are oriented

to less liquid investments such as venture capital stakes in small companies.

- Increasing Flexibility. The Commission's initiatives include numerous regulatory changes to permit greater variation in distribution and other practices by mutual funds and other investment companies, while preserving full public disclosure. These changes will encourage greater innovation in the industry, and a wider range of choices for investors.

Reducing Burdens on the Trading Markets

The capital markets rely on a vast network of financial intermediaries and trading markets. Fair and liquid trading markets enhance the attractiveness of investments in securities. Market participants (such as brokers, dealers and transfer agents), exchange and over-the-counter markets and support systems for these markets (such as clearing agencies and depositories) are all essential to the process of raising and reallocating capital. Consistent with the paramount goal of investor protection, the Commission is considering several initiatives to eliminate unnecessary burdens on market participants and trading markets and improve market efficiency.

These include:

- Simplification of Broker-Dealer Registration and Reporting Requirements. The Commission has proposed, and will be taking final action on, amendments to the basic registration form for broker-dealers, Form B-D, to clarify and simplify disclosure requirements. The staff is also working with state regulators toward development of a one-stop filing system for state and federal registration of broker-dealers.
- Streamlining Trading Practice Rules. The Commission will be considering streamlining trading practice rules that apply to conduct of participants in the distribution of securities. Proposed revisions will take into account the effect of these rules on international offerings, the application of these rules to securities firms that have affiliates acting as market makers or specialists, and contemporary market practices and trading technologies.

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For nearly six decades, the SEC has administered the unique regulatory system embodied in the federal securities laws to protect American investors and maintain the fair and orderly markets that are essential to capital formation. The proposals

described in this Report are intended to ensure that this regulatory system will continue to promote the broad investor participation that is needed to maintain the competitiveness of the American economy.