The Honorable
Charles W. Tobey, Chairman
Committee on Banking and Currency
United States Senate
Washington, D. C.

May 20, 1947

Re: S. 1099

My dear Senator:

Pursuant to the request of your Committee, transmitted to us by Mr. Hill, we are submitting herewith our views as to the merits of S. 1099 which would amend Section 7 of the Securities Act of 1933.

As you know, it is the fundamental philosophy of the Securities Act of 1933 that when the public is asked to finance a business enterprise it is entitled to have presented to it a fair picture of that enterprise. Accordingly, the present Act requires fair disclosure of every essential element concerning the company in which the investor is invited to acquire an interest, so that he may formulate an intelligent and informed judgment as to whether or not he wishes to invest his savings in the venture. In our opinion, S. 1099 conflicts with the basic philosophy of the Act in that it would make it unnecessary to disclose certain essential and basic information to persons solicited to invest in new and promotional enterprises. The bill would seriously lessen the informational requirements of the Act in the case of untested enterprises as to which little or no factual information is publicly available – an area in which the public is most strikingly in need of enlightenment and protection.

The basic items of information which must be disclosed to the public under the present Act are set forth in detail in Schedule A of the Act. There is no necessity to discuss here Schedule B which relates only to issues by foreign governments or political subdivisions thereof. The items of information contained in Schedule A represent the minimum of information which the Congress deemed essential to informed judgment. Thus, pursuant to Schedule A, the investing public must be informed as to the character and scope of the business; there must be provided a description of the corporate structure and the particular security offered, as well as a statement of the specific purposes for which the new money is to be used. Disclosure must be made of the more important underlying commitments of the enterprise, subject to confidential treatment in appropriate cases. Balance sheets and other financial data are required.

The schedule requires the disclosure of information revealing the persons with whom the investor is and will be dealing, such as promoters, directors, principal officers, dominant stockholders and underwriters. The investor also must be provided with information as to the stake of such persons in the enterprise, as to the direct and indirect remuneration or profits they have received in the past from the company or are expected to receive from it in the future. Information must be given as to bonus and profit-sharing arrangements and as to any hidden interests of such persons or others in the venture. The

existence of options which might result in the dilution of the investor's interest in the company must be disclosed. He must be informed as to the cost of the security to the issuer and its price to him and to other investors, as well as the total amount which actually will be channeled into the enterprise. These and other vital facts must be provided to the investor so that he can exercise an independent judgment as to the advisability of investing in the company.

The information set forth in schedule A is brought home to the investor through the medium of the registration statement filed with the Commission and the statutory prospectus which must be used in connection with sales. These media serve not only as a source of information to the investor, but also as a foundation for civil liability if the information contained therein is false or misleading.

The informational requirements contained in Schedule A are not absolute in their application to various types of enterprises. There are certain types of issuers to whom various of the items of information specified in Schedule A are inapplicable. Accordingly, Section 7 of the Act provides that the Commission may by rules and regulations permit the omission of any information or documents as to particular classes of issuers if it finds that the requirement is inapplicable to such class and that disclosure fully adequate for the protection of investors is otherwise required to be included within the registration statement. Pursuant to this authority, the forms for registration adopted by the Commission permit the omission of items of information inapplicable to the particular class of issuer. For example, it is plain that in the case of new issuers or issuers still in the development stage, the formal detailed balance sheets, profit and loss statements and other financial statements specified under Schedule A are inappropriate. Accordingly, the registration forms provided for use by such companies permit the filing of simple statements of cash receipts and disbursements, and schedules of assets, liabilities and securities in lieu of the more formal statements referred to above.

A similar flexibility is provided in the Act for those cases in which experience demonstrates the need for additional disclosures. Under Section 7 of the Act the Commission is empowered to require, by rules and regulations, the disclosure of information in addition to that specified in Schedule A when it is necessary and appropriate in the public interest or for the protection of investors. It has been the Commission's experience that the present Act is sufficiently flexible to enable the Commission to adjust its requirements to any type of issuer or to an issuer in any stage of development.

In this same connection, there should be noted the exemptions from registration contained in the Act, which provide a further elasticity in cases where the informational requirements of the Act might possibly prove burdensome to small or local ventures. Where the conditions of these various exemptions are complied with, the informational requirements of the Act are inapplicable. Thus, purely local issues are fully exempted from the registration requirements of the Act under Section 3(a)(11) thereof. Similarly, under Regulation A adopted by the Commission pursuant to Section 3(b) of the statute, an issuer may in general offer $300,000 in securities in any single year without

complying with the registration requirements of the Act. We suggest that any consideration of the necessity for a revision of the type contemplated by S. 1099 must be made in the light of the provisions discussed above.

S. 1099 would amend Section 7 of the Act by substituting a new Schedule C for Schedule A in the case of securities issued by an issuer engaged in the promotion or organization of a new business enterprise. The new schedule would require the disclosure of some of the items of information now required, but would permit the omission from the registration statement of many other informational items which are essential to informed judgment in the case of any security and particularly in the case of securities of new and promotional enterprises.

It has been said that in the last analysis business like government depends on men and that, therefore, an investor is entitled to know with whom he is dealing and their interests in the issuing company. S. 1099, however, would require no information as to the dominant stockholders of the corporation and their holdings, or the holdings of directors, principal officers, or promoters. Nor would information be required as to the underwriters. Although the investor should be informed as to the transactions had by promoters with the company, the consideration paid by promoters for their stock and the value of property transferred by them to the company, the bill would not require such disclosure. Under the bill, the investor would receive no information as to the remuneration paid or proposed to be paid to directors and others. No disclosure would be required as to the indirect benefits, compensation or remuneration which such persons have received or may receive through transactions with the corporation, nor as to the existence of options or bonus and profit-sharing arrangements.

Moreover, under the bill no disclosure would be required as to the public offering price of the security, nor as to any variation of that price for any favored class of persons. The investor would receive no information as to the spread or discount taken by underwriters and the expenses of the issue. Thus, although the investor in a promotional enterprise should know what proportion of his particular investment will be channeled into the enterprise, he would be unable to ascertain that fact from the registration statement with any degree if certainty. No disclosure would be required under the bill as to the important underlying commitments of the enterprise on which its success may depend. The investor would not be given financial data which might enable him to determine the position of the company as of the time of the offering.

Where funded debt as distinguished from equity securities are being offered, the bill would not require that any description of such funded debt be given to the investor. The result in such cases would be that the investor would not be apprised of the nature of the interest which he is purchasing in the enterprise, nor would he be in a position to assess its rank or priority in the event of a distribution of the assets. The bill also fails to require that the underwriters be named. Thus, the civil liability provisions contained in Section 11 of the Act as to such persons would be rendered a practical nullity. Also, the bill would permit the omission from the registration statement of all highly important

exhibits, such as the opinion of counsel as to the legality of the issue, material contracts, agreements with underwriters, and the issuer's charter and by-laws.

Finally, it should be noted that the bill would not revise that portion of Section 7 of the Act which empowers the Commission to require the disclosure of information in addition to that specified in the schedules, where such additional disclosure is necessary or appropriate in the public interest or for the protection of investors. For the reasons heretofore stated, the Commission in the normal case would feel impelled to adopt rules requiring the disclosure of the information omitted from Schedule C which, as we have pointed out, is necessary if investors in new and promotional enterprises are to be accorded protection. However, if S. 1099 were enacted a serious question would be presented as to whether the Commission's exercise of rule-making power to require the information which it believed necessary for the protection of investors, would not be in direct contravention of the intention of the Congress in enacting S. 1099. We believe that the Commission should not be put in such an ambiguous position as would result from a direction on the one hand to enact rules requiring necessary information and an indication apparent from the enactment of S. 1099 that Congress did not regard as significant the information which seems of such vital importance to the Commission.

The benefits obtained by the public from the type of disclosure suggested by the bill would be wholly illusory since it would be unnecessary to furnish investors with basic information as to many items indispensable to an informed evaluation of the enterprise. While the Act purportedly would continue to be an instrument for full disclosure, it would in fact give official sanction to a form of limited disclosure wholly inconsistent with the objectives of the legislation and the interests of investors. We believe that the ultimate result of such a revision would be a loss of public confidence in the Act and, more important, a possible recurrence of the lack of confidence in investments which characterized public feeling after the financial debacle in 1929, and was one of the forces impelling the enactment of the present statute.

The Commission feels that responsible members of the public are wholeheartedly committed to the aims of the Securities Act and that the fruitful areas of adjustment lie in easing the burdens of compliance without prejudice to the interests of investors. When the minimum requirements for disclosure set forth in the present Schedule A are considered in the light of the history of corporate finance, it seems plain that the disclosures required are not needlessly searching. Indeed, they are vital and necessary if there is to be fair play and honest dealing in the solicitation of capital for enterprises, new or old. We do not consider that any business enterprises conducted with common honesty is unduly burdened by the disclosures required in Schedule A. On the other hand, the revision contemplated by S. 1099 would clearly be prejudicial to the interests of investors. For those reasons, the Commission urges that the bill should not be enacted into law.

As your Committee knows, the Commission is presently engaged in a joint study, with interested groups, of the provisions of the Securities Act of 1933 and the Securities Exchange Act of 1934, in order that a workable program for revision of the Acts may be

presented to the Congress. It would, in my opinion, be unfortunate to revise either of the Acts in any respect until such time as a comprehensive and considered report of our study can be presented.

We greatly appreciate this opportunity to express our views concerning S. 1099. If we can be of service to your Committee in the future, please do not hesitate to call on us again.

Sincerely,

James J. Caffrey
Chairman

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