

U. S. Securities and Exchange Commission

Briefing Paper: Proposed rulemaking to implement the integrated disclosure system.

[This summary of the eight releases comprising this phase of the integrated disclosure program has been prepared to assist persons attending the open Commission meeting scheduled for July 30, 1981, at which the releases are considered. Users of the summary should be aware that it is neither exhaustive nor definitive and that the Commission may determine to make changes in the rulemaking recommendations described herein.]

The Commission today is considering a group of eight releases which represent its most significant effort to date to implement an integrated corporate disclosure system, which will affect the over 9,000 public companies subject to reporting obligations under the federal securities laws. The disclosure systems under the federal securities laws are of great importance to capital raising and investor protection in the securities markets. Last year, over \$600 billion in equity securities were traded on exchanges and in the over-the-counter market. There were public offerings of over \$100 billion in equity and in debt securities. The continuous reporting system imposed by the Securities Exchange Act of 1934 (the "Exchange Act") and the registration system mandated by the Securities Act of 1933 (the "Securities Act") facilitate this trading activity and capital formation by assuring that investors and the market place are given the information necessary for investment decisions.

The integrated disclosure system harmonizes the two disclosure systems — which have grown up independently and on a largely piece-meal basis for the more than forty years since the statutes were enacted — into a single comprehensive disclosure system. It will perform the roles envisioned by both statutes

but, at the same time, will eliminate or reduce the overlapping or duplicative corporate reporting, which was the product of two distinct systems, and will streamline corporate reporting generally.

Today's action is part of an ongoing process to integrate the disclosure systems. The foundation was laid by rulemaking actions taken over a period of more than ten years, but the most critical steps have been taken in the past two years. The Commission is considering all eight releases as proposed rulemaking actions rather than taking any final action at this time. While this means the republication of some proposals which have already been the subject of public comment, the Commission believes that publication of the eight releases together will allow the public to see the complete system before it is adopted. This will give the Commission the benefit of public comment not only on the individual components of the system, but also on their interaction. It should be noted, however, that today's proposals reflect and, in many instances, incorporate changes responsive to the public comments received in connection with the original proposal of these actions. Comments already received will continue to be considered until this rulemaking effort is completed and need not be repeated or resubmitted. The comment period on today's eight proposals closes on October 30, 1981, and the Commission plans to take final action promptly thereafter.

Overview

The integrated disclosure system simplifies corporate reporting in three ways: (1) disclosure requirements are made uniform under the Securities Act and the Exchange Act; (2) Exchange Act periodic reporting is used to satisfy much of the disclosure necessary in Securities Act registration state-

ments; and (3) the use of informal shareholder communications is encouraged, but not required, to satisfy formal statutory requirements under both Acts. The Commission adopted the first components of the integrated disclosure system in 1980 and early 1981. */ In addition, other components were proposed for comment. These outstanding proposals and the five newly developed coordinating projects being considered today are as follows:

(1) Proposed Forms S-1, S-2 and S-3 to establish a new three tier system for the registration of securities under the Securities Act. These forms were originally proposed as Forms A, B and C in Securities Act Release No. 6235 (September 2, 1980) (the "ABC Release").

(2) Revision and expansion of Regulation S-K and rescission of the Guides for the Preparation and Filing of Registration Statements and Reports (the "Guides"), other than the Guides relating to specific industries. These changes were originally published in Securities Act Release No. 6276 (December 23, 1980) (the "Guides Release").

(3) General revision and "sunset" review of the procedural requirements of Regulation C under the Securities Act and Regulation 12B under the Exchange Act.

*/ The integration program components adopted in 1980 and to date in 1981 are: (1) the amendments to Form S-8 to allow automatic updating of registration statements on that form through reliance on Exchange Act periodic reports, Securities Act Release No. 6202 (April 2, 1980); (2) the adoption of a new uniform exhibit requirements item in Regulation S-K, Securities Act Release No. 6230 (August 27, 1980); (3) the restructuring and substantial revision of Form 10-K and the annual report to security holders pursuant to Rule 14a-3, Securities Act Release No. 6231 (September 2, 1980); (4) the revision of Regulation S-X to attain uniformity

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(4) New Rule 462A under the Securities Act governing the registration of securities to be sold in delayed or continuous offerings. This rule was originally published as part of the general revision of Regulation S-K and the Guides in the Guides Release.

(5) New Rule 176 under the Securities Act relating to the responsibility in an integrated disclosure system of persons subject to Section 11 of the Securities Act and re-proposed provisions relating to the effective date and modifying and superseding statement aspects of documents incorporated by reference. The latter provisions were previously published for comment in Securities Act Release No. 5988 (November 17, 1978) and the ABC Release.

(6) New Rule 436(g) and amendment to Rule 134(a) under the Securities Act to facilitate the Commission's decision to permit the voluntary disclosure of security ratings.

(7) Amendments to existing Securities Act registration forms to coordinate those forms with revised Regulation S-K and other aspects of the integrated disclosure system.

(8) Amendments to Exchange Act rules, forms and schedules to coordinate with revised Regulation S-K and other aspects of the integrated disclosure system; amendments

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between financial statements presented in Commission filings and those in annual reports to shareholders as well as to achieve uniform requirements for income statements (three years) and balance sheets (as of end of two years) to be presented in all Commission filings, Securities Act Release Nos. 6233 and 6234 (September 2, 1980); (5) the adoption of new Form S-15, a short form for Securities Act registration in connection with certain business combinations, Securities Act Release No. 6232 (September 2, 1980); and (6) the adoption of revisions to Form 10-Q and Regulation S-X and S-K to streamline interim financial reporting and make requirements uniform under both Acts, Securities Act Release No. 6288 (February 9, 1981).

to Rule 175 under the Securities Act and the corresponding safe harbor rules relating to projections under the other federal securities laws to broaden and clarify the scope of protection provided thereunder; and amendments (reproposed without change) to Schedule 14A relating to business and other relationships between a director and an issuer and the vote required for the election of directors.

Each of these releases is integrally related to the others and to the rulemaking actions taken in 1980. In the integrated disclosure system, a Securities Act registrant looks (1) to the available form for a determination of the type and amount of disclosure which must be delivered to investors, (2) to Regulation S-K for substantive disclosure requirements and (3) to Regulation C for procedural regulations. Separate releases address the role in the integrated system of security ratings, delayed or continuous offerings and Securities Act liabilities in connection with Exchange Act periodic reports incorporated by reference into Securities Act registration statements. Finally, the Commission's integration of the two existing corporate disclosure systems includes a wide ranging "sunset" review, resulting in revisions to Regulation C and in the proposed coordinating changes to rules and forms under the two systems.

The eight releases contain comprehensive discussions of the proposed actions as well as texts of the proposed rule and form provisions. This summary is intended to assist persons interested in the integrated disclosure system in their consideration of the releases.

Proposed Forms S-1, S-2 and S-3

The proposed Securities Act framework would establish three categories of registration statements. Proposed Form S-3 relies on the efficient market theory and thus allows maximum use of incorporation by reference of

Exchange Act reports and requires minimal disclosure in the prospectus. In addition to being available for equity offerings by companies widely followed in the marketplace, Form S-3 could be used by most reporting companies to register investment grade debt offerings, securities offered under dividend and interest reinvestment plans and rights offerings, conversions and warrants. Companies which have been subject to the periodic reporting system of the Exchange Act for three or more years, but which are not as widely followed, would be eligible for Form S-2, which combines reliance on incorporation by reference of Exchange Act reports and presentation of streamlined information in the prospectus or in an annual report to shareholders delivered with the prospectus. Companies which have been in the Exchange Act reporting system for less than three years, and any others who choose to do so, would use Form S-1, which requires complete disclosure in the prospectus and permits no incorporation by reference.

A critical issue in Forms S-1, S-2 and S-3 has been developing criteria for determining when and by whom the abbreviated forms may be used to register securities. Since the use of abbreviated disclosure is based, to a large degree, on the theory of an efficient market, the criteria for the use of Forms S-2 and S-3 are designed to be indicative of following in the market place. The Commission believes that the standards of Exchange Act reporting experience and a minimum value of voting stock held by non-affiliates (the "float") are indicative of market place following, and thus it has moved away from registrant quality criteria (such as net income). The Commission is proposing a \$150 million float test for Form S-3, which results in approximately 30% of NYSE, AMEX and NASDAQ companies being eligible to use the Form, and is also considering an alternative

test involving two market factors, a \$100 million float and 3 million share annual trading volume, which would address regionally followed companies.

Revision of Regulation S-K

The revision of Regulation S-K represents the evolution of that regulation into the repository of uniform disclosure provisions relating to substantially all of the information to be set forth in registration statements under the Securities Act and in annual and other periodic reports required pursuant to the Exchange Act. Disclosure requirements are centralized in Regulation S-K in order to avoid the need to refer to multiple sources for document content requirements. Thus, certain disclosure requirements currently included in the Guides, in proposed Form A, in Regulation C and in various Securities Act registration forms and Exchange Act forms will now be moved to Regulation S-K.

The Regulation S-K release also represents the completion of the "sunset" review of the Guides. In addition to including certain substantive Guide provisions in Regulation S-K, the "sunset" review of the Guides has resulted in including certain procedural provisions in Regulation C and deleting 50% of the Guides as obsolete. The only remaining Guides will be those relating to specific industries, where greater flexibility is essential.

Revision of Regulations C and 12B

The rules comprising Regulation C and Regulation 12B were adopted to standardize the mechanics of securities registration under the Securities Act and Exchange Act, respectively. The rules implement the statutes and provide more specific instructions for registrants than are contained

in the statutes. Although these regulations developed over a long period, no overall review of their provisions had been undertaken for some time. The Commission believes a comprehensive review of Regulation C and Regulation 12B is appropriate at this time in order to implement fully the integrated disclosure system and to continue the Commission's ongoing "sunset" review of its regulations.

The proposed amendments will simplify and clarify procedural requirements and conform the provisions of Regulation C and Regulation 12B to the procedures established in the integrated disclosure system. These amendments involve revising existing provisions, incorporating certain procedural requirements from the Guides and the current registrations forms into Regulation C, moving certain Regulation C provisions relating to substantive disclosure and document content into Regulation S-K. The "sunset" amendments, which revise, up-date or delete provisions where appropriate, include the proposed rescission of 23% of the rules now contained in Regulation C.

Delayed or Continuous Offerings

Proposed Rule 462A, which was first published in the Guides Release, would facilitate new methods of financing. For the first time, the Commission would specify by rulemaking the conditions under which registrants could register securities to be offered on a delayed or continuous basis on the market (so called "shelf registration"). The proposal would codify staff practice concerning "traditional" shelf offerings, such as securities to be offered in a continuing acquisition program. It would permit, for the first time, the registration of securities that the issuer did not intend to offer immediately to the public or that it intended to sell gradually on a non-fixed

price basis over time depending on market conditions. Also, the proposed Rule would permit an issuer to sell the securities registered on the shelf in a succession of different kinds of offerings. The proposed shelf rule is designed to relieve processing pressures upon the Commission staff and to facilitate capital formation by granting issuers ready access to the markets.

Liability Issues

Some members of the financial community have expressed concerns about the integrated disclosure system because it relies on Exchange Act periodic reports to satisfy Securities Act registration disclosure requirements and allows rapid financings. These persons believe that underwriters may have diminished opportunity to conduct what would be deemed a reasonable investigation of the information incorporated by reference from Exchange Act reports into a Securities Act registration statement so as to discharge their obligations under Section 11(b) of the Securities Act. In light of these concerns, the Commission is publishing for comment several proposals addressing the questions of liability which arise in the context of the integrated disclosure system. While the proposed rules would not derogate from Section 11 with respect to the responsibilities of underwriters, they would set forth certain factors which bear on issues of liability.

First, proposed Rule 176 would codify Section 1704(g) of the draft Federal Securities Code, as modified and approved by the Commission in 1980. The proposed rule identifies certain circumstances, including incorporation by reference, which may bear upon the determination of what constitutes reasonable investigation and reasonable ground for belief as those terms are used in Section 11.

Second, the Commission is proposing to codify in Regulation C the previously proposed provisions regarding the effective date of documents incorporated by reference and the making of modifying or superseding statements. These provisions are substantially the same as those originally proposed as amendments to Form S-16 after that form was amended to allow its use for primary offerings and repropoed as part of the Form A incorporation by reference item.

Security Ratings

The Commission traditionally has taken the view that disclosure of the security ratings assigned to classes of debt securities and preferred stock by certain professionals rating organizations generally should not be permitted in filings under the Securities Act. In 1977, the Commission issued a concept release concerning whether such disclosure should be allowed or required, in what filings any such disclosure should be made, and what related information, if any, should be disclosed in those filings. */ Since 1977, the Commission has continued to consider the issue, particularly in the context of the integrated disclosure system. The Commission now has determined to permit the voluntary disclosure of such ratings in filings with the Commission. The security rating release sets forth the Commission's views with respect to other information that should be included with the security rating in order that such rating, standing alone, not be misleading or confusing to investors.

*/ Securities Act Release No. 5882 (November 3, 1977).

To facilitate this change in policy, the Commission is publishing two proposals: an exemptive rule, Rule 436(g), concerning issues of expert's consent and liability under the Securities Act; and an amendment to Rule 134 permitting the disclosure of security ratings in tombstone advertisements.

Securities Act Coordinating Release

As part of its efforts to implement a comprehensive integrated disclosure system, the Commission is proposing to amend existing Securities Act registration forms. These amendments are the result of a review of existing forms that was designed (1) to identify additional places where the Regulation S-K uniform disclosure items may be referred to in lieu of individual form items containing substantially similar requirements; (2) to conform existing references to Regulation S-K with the proposed revisions thereto; and (3) to conform other Securities Act forms, wherever possible, to the instructions, format and requirements of proposed Forms S-1, S-2 and S-3. In addition, the Commission is proposing to rescind five rarely used registration forms.

Exchange Act Coordinating Release

The Commission also is proposing amendments resulting from an examination of Exchange Act continuous disclosure and proxy-related rules, forms and schedules. This review was undertaken toward the same end of coordination with other aspects of the integration rulemaking program, particularly the revision of Regulation S-K, as well as with a view to

streamlining and improving the quality of Exchange Act disclosure which is so critical in the integrated disclosure system. As in the Securities Act context, the Commission also is proposing to rescind six rarely used forms, three for registration and three for annual reporting.

This release also proposes amendments to broaden and clarify the scope of safe harbor protection available under the various securities acts for disclosure of forward looking statements. The affected rules are Securities Act Rule 175, Exchange Act Rule 3b-6, Public Utility Holding Company Act Rule 103A, and Trust Indenture Act Rule 0-11. The amendments would correct an inconsistency in the scope of the rules as currently in effect to permit projections for first-time Exchange Act registration just as is permitted currently for first-time Securities Act registration.

The proxy statement amendments relating to business and other relationships between issuers and directors and to the vote required for the election of directors are republished without change and, thus, need not be reconsidered specifically.

Conclusion

The Commission's proposed integrated disclosure system represents fundamental changes in corporate reporting which will affect directly the more than 9,000 public companies subject to the reporting obligations imposed by the federal securities laws. These changes are intended to reduce costs and burdens while maintaining investor protection. Interested parties are invited to assist in the final phase of this program by commenting on those new aspects of the proposals and, if they desire, upon the program as a whole.