

**Securities Industry Association**

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November 13, 1996

Mr. Jonathan G. Katz
Secretary
Securities and Exchange Commission
450 Fifth Street, N.W., Stop 6-9
Washington, D.C. 20549

Re: Securities Act Concepts and Their Effects on Capital Formation -- File No. S7-19-96

Dear Mr. Katz:

The Capital Markets Committee of the Securities Industry Association ("SIA") ¹ is pleased to submit this response to Release No. 33-7314 ("Concept Release") on behalf of SIA. ²

We wish to commend the Commission, the Advisory Committee on the Capital Formation and Regulatory Processes ("Advisory Committee") and the Task Force on Disclosure Simplification ("Task Force") on their initiatives to re-examine regulation of the nation's capital-raising process. While the United States has a capital market and regulatory regime that are generally efficient, effective and the models for many other countries, continued review and vigilance to ensure that the system remains competitive and is as effective as possible are always in order. This is especially true now. As the Commission has often noted, fundamental changes have occurred and will continue to occur in the securities markets as the result of rapid and significant advances in technology and communications, the effective breakdown of geographical barriers and the globalization of the marketplace, and the continuing institutionalization of large segments of the securities markets. The character, pace and magnitude of these changes in the capital formation process have created a pressing need for prompt reform of certain regulatory concepts and procedures.

The Concept Release raises numerous important, and fundamental, questions regarding the application of the Securities Act of 1933 and the rules thereunder to securities offerings. In this letter, we address those Securities Act concepts as to which the need for reform is most urgent, and suggest revisions which could, and should, be implemented as soon as possible.

For the reasons discussed more fully below, we believe the Advisory Committee's proposal regarding company registration should not be adopted. Improved disclosure in Exchange Act documents has been suggested as a primary justification for the paradigm shift from a transaction registration approach to a company registration model. After careful consideration of

the suggested modifications to the Exchange Act reporting process contained in the Advisory Committee proposal, however, it is our professional judgment that they generally will not achieve the desired effect. To the extent the goal is to allow issuers improved access to the capital markets and to deal with certain conceptual issues, we believe that most of the benefits of the company registration proposal can be achieved more simply, more expeditiously and at lower cost -- while preserving important advantages and benefits of the regulation of securities transactions -- by implementing the suggestions set forth below with respect to the following nine specific areas:

- private placements
- restricted securities
- pre-marketing activities
- writings and research
- press coverage
- registration procedures
- disclosure requirements
- underwriters' liability
- settlement process

Private Placements

When adopting Rule 144A in 1990, the Commission characterized the "initially limited form" of the Rule being adopted as "the first step toward achieving a more liquid and efficient institutional resale market for unregistered securities" and stated its intentions "to monitor the evolution of this market and to revisit the Rule with a view to making any appropriate changes."

The Commission has carried out its intention to monitor the development and evolution of the Rule 144A market. As a result, the Commission is aware that the adoption of Rule 144A in 1990 has allowed for significant improvements in the efficiency and liquidity of the U.S. private placement market, and that these improvements have provided substantial benefits for both issuers and sophisticated investors. Furthermore, Rule 144A has greatly enhanced the competitive position of the United States in the global securities markets. We do not believe that the development and growth of the Rule 144A market has had any adverse effect on the public market.

Now that Rule 144A has been in successful operation for more than six and one-half years, the Commission should extend the important reform of the U.S. private placement market which it began in 1990. The Rule 144A market should be expanded to a wider range of qualified buyers, and certain unnecessary restrictions should be eliminated. These changes will strengthen the Rule 144A market by enhancing its liquidity and efficiency and should provide issuers with greater flexibility to raise capital on an unregistered basis at reduced costs and with less regulatory delay, and in a manner consistent with the protection of investors.

Expand the Qualified Buyer Market. Expanding the universe of investors covered by Rule 144A will substantially enhance the efficiency and liquidity of that market for the benefit of all its participants, without in any way reducing the investor protections for those who need the benefits of registration under the Securities Act. The Commission should (1) reduce the

minimum required size portfolio for non-broker-dealers from \$100 million of securities to \$25 million of investments (which should include securities, cash, money-market instruments, commodity futures and other similar financial assets) and (2) expand the type of buyer to include any person, *i.e.*, any entity or individual, in order to increase the number of sophisticated buyers who may purchase Rule 144A securities and allow issuers greater access to capital. Requiring all non-broker-dealers to have investments of at least \$25 million would still assure that only those investors who are sophisticated with respect to investments would be qualified to purchase under Rule 144A. This is amply demonstrated by the less stringent definition of "qualified purchaser" in the recently enacted National Securities Markets Improvement Act of 1996 ("1996 Act"), which identifies those investors whom Congress considers to be sophisticated enough to purchase securities in unregistered offerings of unregulated investment vehicles.

In addition, whatever the level of the threshold, it is unnecessary and illogical to exclude any individuals who meet that threshold in their own right. We recognize that, in theory, an individual having a portfolio that large can already participate in the Rule 144A market by forming a corporation to hold his or her securities. We see, however, no reason why such individuals should be put to the time and expense of taking that approach. While forming an entity may be relatively straightforward for some, for others implementing such approach might force them to incur unnecessary tax, legal and administrative costs. In any event, the form of ownership is irrelevant to the key issue, namely, the investor's sophistication and ability to make investment decisions without Securities Act registration. Accordingly, we believe that qualified buyers should include any person, *i.e.*, any entity (however formed) or any individual who satisfies the investments threshold. We note that under the 1996 Act "qualified purchaser" includes both individuals and institutions, and that the \$5 million investments threshold for individuals is substantially lower than the \$25 million threshold for institutions. Indeed, some SIA members believe that the thresholds for qualified buyers under Rule 144A should be the same as those in the definition of "qualified purchaser" enacted by Congress.

Rule 144A also should be amended to expressly acknowledge that sellers may rely on a qualified buyer's or intermediary's certification as to the qualified status of the accounts for which the buyer is acting. Requiring anything more is simply not practical in today's highly competitive securities markets. Most qualified buyers acting for the accounts of other qualified buyers are extremely reluctant to identify these accounts to the seller, and often refuse to do so. This amendment would increase the efficiency of the Rule 144A market by relieving sellers of a paperwork burden that is impractical and unnecessary for the protection of investors and by placing the responsibility for determining qualified status appropriately on the person best positioned to make such determination.

Amend Rule 144A to Delete References to Offers. The availability of Rule 144A should be determined with reference to those who actually purchase the securities rather than to the identity of all offerees. This approach is taken in Regulation D, even though the thresholds for "accredited investor" under Regulation D are much lower than those proposed above for qualified buyers under Rule 144A. We see no justification for not following the same approach in Rule 144A.

In addition, deleting the reference to offers would permit public dissemination of quotations in trading systems for restricted securities (for example, Autex, Bloomberg and Instinet). This

would enhance the liquidity and efficiency of the Rule 144A market and eliminate an unnecessary restraint on the flow of information in the present world of electronic communications.

In the Rule 144A context, it is difficult to see any harm to offerees who do not purchase any securities. Restricting eligibility for the exemption by reference to actual buyers rather than offerees is all that is necessary for the protection of investors. The Commission recognized this when it adopted Regulation D in 1982.

Narrow the Definition of "Fungible Securities". Assuming the Commission wishes to continue to exclude exchange-listed and Nasdaq securities from Rule 144A, then only securities that actually are fungible with exchange-listed or Nasdaq securities should be excluded. For example, not only convertible securities and warrants that meet the 10% minimum premium requirement, but also those that are not convertible or exercisable until at least six months after issuance, should be considered to be non-fungible with the underlying common stock based upon traditional market dynamics (in each case, even if the issuer has the option to redeem the convertible security or warrant and deliver shares of common stock in payment of the redemption price, so long as the security or warrant may not be so redeemed until at least six months after issuance). In this context, the Commission should explicitly permit mandatorily convertible or exchangeable securities to qualify as non-fungible securities.

Narrow the Definitions of "General Solicitation" and "Directed Selling Efforts". The Commission should amend Regulation D and Regulation S to expressly permit press activities within the expanded safe harbor recommended under "Press Coverage" below.

If and to the extent that there are substantive restrictions on the dissemination of offering materials relating to an unregistered offering, the Commission should expressly provide that the issuer or broker-dealer may rely on reasonable "gateway" procedures in connection with the dissemination of offering material by electronic or other means (for example, by requiring that any person seeking access must affirm its status as a qualified buyer). In addition, there should be formal acknowledgment that accessibility of research reports on electronic data bases is not considered to be publication or re-publication of the research, *i.e.*, where a research report was previously included in an electronic database (for example, on an Internet site), it is permissible to leave the research in the database during the offering.

The Commission should also amend Regulation D and Regulation S to make clear that "general solicitation" and "directed selling efforts" do not include the dissemination of any written materials permitted under various safe harbors, including those amended as suggested under "Writings and Research" below, or any pre-marketing activities covered by the amended safe harbor suggested under "Pre-Marketing Activities -- `Testing the Waters'" below.

Narrow the Definition of "Affiliate". We agree with the Advisory Committee's observation that the primary purpose of requiring sales by affiliates to be registered is "to ensure that companies do not create a public market for their shares indirectly through sales by their controlling or controlled persons when adequate information is not available concerning the issuer." We believe it would be appropriate to adopt the proposal in the Report of the Advisory Committee that would clarify the concept of "affiliate" by adopting a rebuttable presumption that only holders of 20% of voting power, holders of 10% of voting power with at least one director on the

board, the Chief Executive Officer, inside directors and director representatives of controlling shareholders are affiliates. This clarification should be adopted whether company registration is implemented or not. We also believe that sales by other officers and directors of the issuer should be treated as affiliate sales if the seller is in fact acting as a conduit for the issuer, such as where the officer or director is using the proceeds of sale to purchase securities from the issuer. The Commission should also adopt a rebuttable presumption that all other persons are not affiliates of the issuer.

Definition of "Underwriter". The definition of "underwriter" is central to the statutory scheme for the registration of securities. We do not support changing the concept without further study of the full implications and consequences under the Securities Act.

Restricted Securities

We support the Commission's efforts to enhance the utility of Rule 144 by broadening the safe harbor it provides for resales of "restricted" securities. In particular, we strongly endorse the Commission's proposal in Release No. 33-7187 to reduce the two-year holding period in Rule 144(d) to one year and to reduce the three-year holding period in Rule 144(k) to two years. In both cases, we believe that, given the volatility of securities markets, such proposed holding periods are sufficient to ensure that persons relying on Rule 144 are not engaged in a public distribution of securities that is inconsistent with the exemptions provided by Sections 4(1) and 4(3) of the Securities Act. For the same reasons, the three-year holding period in Rule 145(d)(3) should be reduced to two years.

The utility of Rule 144 would be enhanced by an amendment providing that in calculating its holding period a holder of "restricted securities" may assume that they have not been owned by an affiliate of the issuer unless the holder has actual knowledge to the contrary. This would help clarify when securities in DTC, Euroclear and CEDEL are no longer restricted and would reduce the paperwork burdens of participants in the restricted securities markets without reducing meaningful investor protections.

Our comments on certain aspects of Rule 144 and the related hedging issues raised in Release No. 33-7187 are set forth in SIA's letter of September 19, 1995 (File No. S7-17-95).

Pre-Marketing Activities -- "Testing the Waters"

The Commission should explicitly permit registered broker-dealers to assist issuers in "testing the waters" in anticipation of a private or public offering. For the reasons discussed in our letter of September 19, 1995 (File No. S7-18-95), we do not support the Commission's earlier, much broader proposal to permit "testing the waters" (proposed Rule 135d). We remain very concerned that allowing unregulated persons and persons not experienced in the capital formation process to solicit indications of interest from investors without having to comply with the Securities Act registration procedure may impair the quality and efficacy of our capital formation process, reduce investor protections and dilute investor confidence in the U.S. capital markets. On the other hand, we continue to agree with the Commission that preparation of all required compliance material under that process may involve "significant expense" and that the economic interests of developing enterprises "is not benefitted by issuers finding out later rather than sooner that the public markets are not the most appropriate forums for their capital raising."

We believe that prospective issuers are most likely to obtain a realistic assessment of their ability to raise capital in the public markets when they enlist the services of regulated professionals engaged in and experienced with the capital raising process. Registered broker-dealers engaged in the underwriting business have every incentive to identify the appropriate capital raising structure and bring an issuer to market if there is an adequate probability of success. On the other hand, they also have every incentive not to encourage unrealistic capital raising expectations if the probability of a successful offering does not justify the issuer's incurring the significant time and expense of undertaking to comply with the registration requirements of the Securities Act. Moreover, in general the underwriter will be in a much better position to make an objective, realistic assessment of prospective investor interest and the issuer's readiness for an initial public offering.

Since registered broker-dealers are required to comply with the applicable rules of the Commission and of the NASD, national securities exchanges and other self-regulatory organizations, and are subject to regulatory supervision and to regulatory sanctions for violations, the participation of a registered broker-dealer should address any concerns regarding the effects of pre-marketing activity on investor protection and investor confidence in the capital markets. Accordingly, we believe that the Commission should adopt appropriate amendments to Rule 152 to permit "testing the waters" on this basis.

We do not propose to limit the current ability of an issuer to access the capital markets without the assistance of a registered broker-dealer. Since the regulatory protections mentioned above are not applicable, however, we believe that such access should be subject to compliance with the registration requirements of the Securities Act or the availability of an exemption from such requirements.

The Commission should also modify existing positions of the Staff so as to permit a private placement following the filing of a registration statement under the Securities Act. We believe this modification would be appropriate for all filings but, in any event, should at least apply where there has been no distribution of a preliminary prospectus specifically relating to the security.

Integration. The Commission should reconsider its traditional analysis of whether offers and sales should be considered part of the same "offering". The list of five factors to be considered in determining whether offers and sales should be "integrated", as described 34 years ago in Release No. 33-4552 (1962) and repeated in the note to Rule 502(a) of Regulation D, is overly rigid and not helpful, does not effectively address the realities of today's securities markets or issuers' current financial practices and unnecessarily restricts the ability of issuers to raise capital.

Writings and Research

The Commission should broaden its safe harbors for research reports and other permissible communications in order to free up legitimate research substantially and to address the realities of the present age of electronic communications. In their current form, various rules (including Rules 134, 135, 138 and 139) unduly inhibit the flow of information to investors and contain restrictions that are unnecessary for, and in certain respects detrimental to, the protection of investors. In general, the Commission should reevaluate the traditional precept of "conditioning

the market" and instead permit communications that encourage the dissemination of appropriate information, fully recognizing the realities of present day communications technology.

Limited Notices of Proposed or Pending Offerings. The Commission should expand the safe harbors provided by Rules 134 and 135 in several respects.

An informational notice that is permitted in the context of a registered offering should also be permitted in the context of a lawful unregistered offering (for example, a private placement or a Regulation S offering abroad).

The type of information that may be included in notices of lawful unregistered offerings and of registered offerings prior to the filing of a registration statement should be substantially the same as currently provided in Rule 134 with respect to post-filing notices in a registered offering. Such notices should include the name and address of agents, underwriters and other persons from whom additional information may be obtained. The information furnished would depend on the type of offering and the status of the person making the request (for example, the person's eligibility to purchase securities in the offering).

Notices of offerings that satisfy the conditions of a safe harbor from the registration and prospectus delivery requirements of the Securities Act should also be entitled to a safe harbor from the filing and procedural requirements of the proxy and tender offer rules under the Exchange Act.

Research. The Commission should expand the safe harbors provided by Rules 138 and 139 by (1) broadening the class of issuers that may be the subject of a research report to include any reporting issuer (not just those meeting the requirements for certain short-form registration statements) and also, in the case of Rule 139, any foreign sovereign issuer and (2) having both Rules explicitly apply not only with respect to registered offerings but also with respect to offerings that are exempt from, or otherwise not subject to, the registration requirements of the Securities Act.

In view of the condition that the research be published or distributed by a broker-dealer in the regular course of its business, requiring the subject of the research to be a reporting issuer or a foreign sovereign is the only other condition necessary or appropriate for the protection of investors.

Research that is permitted in the context of a registered offering should also be expressly permitted in the context of a lawful unregistered offering (for example, a private placement or a Regulation S offering abroad). Moreover, research that satisfies the conditions of a safe harbor from the registration and prospectus delivery requirements of the Securities Act should also be entitled to a safe harbor from the filing and procedural requirements of the proxy and tender offer rules under the Exchange Act.

In its current form, Rule 139 imposes artificial, unnecessary and unreasonable restraints on the flow of information to investors. The availability of Rule 139 should not be denied where the broker or dealer is upgrading an opinion, recommendation or projections. It is neither in the best interest of the market nor necessary to impose an artificial restraint on the substance of an analyst's research. The safe harbor should also be available for a broker-dealer that is initiating

research in cases where the subject issuer is already covered by an appropriate level of research by others. A broker-dealer should not be penalized because it has not previously covered an issuer or its analyst was previously employed elsewhere. The key regulatory focus concerning research should be the report's accuracy in presenting the research analyst's professional views, and the Commission has sufficient authority to deal with any fraudulent research.

The Commission should also consider broadening both Rules to include research covering certain non-reporting non-U.S. issuers whose securities are widely traded.

Press Coverage

The rapid advances in global electronic communications technology already implemented have radically altered the realities of the securities marketplace and the flow of information both within and outside the securities markets. In view of the advances that have already occurred and are likely to occur in the future, any attempt to restrict the flow of legitimate market-related information via electronic and print media is not in the best interests of investors or necessary for their protection. The Commission's recent proposal of safe harbors for offshore press activities recognizes that such attempts may not be necessary for the protection of investors and that freer access to information on a timely basis should generally benefit investors. The Commission observed that "[i]n today's global securities markets, corporate transactions involving securities ... are increasingly newsworthy events, regardless of where in the world these transactions are taking place." This observation is also true regardless of where in the world the press activities are taking place, whether the issuer is foreign or domestic, or the extent to which an offering is directed offshore. As the Commission recognizes, the broad policy implications of this reality extend well beyond those situations intended to be covered by the safe harbors proposed in Release No. 33-7356.

A major segment of the press concentrates on financial news, including registered and unregistered securities offerings, and a growing sub-segment focuses specifically on unregistered offerings. Issuers and underwriters do not control members of the press, and all of their communications with the press relating to a securities offering are subject to the antifraud provisions of the Federal securities laws. Much information concerning proposed and pending offerings already appears in the press, and we believe that the accuracy and completeness of that information will be improved with freer access to issuers and their underwriters.

Accordingly, insofar as the requirements of Section 5 of the Securities Act are concerned, we believe that the Commission should eliminate restrictions on *bona fide* press activities, wherever conducted, and that the proposed safe harbors for offshore press activities should also cover press activities in the United States for both foreign and domestic issuers and should extend to offerings made primarily or exclusively in the United States.

The Commission should remind market participants, the press and other media of the existing antifraud provisions against "touting" a security, in particular, Section 17(b) of the Securities Act which prohibits any journalist or other person from publishing or giving publicity to a security for a consideration received, directly or indirectly, from the issuer or an underwriter or dealer, without fully disclosing the receipt and amount of such consideration. The Commission should consider adopting a rule that would prohibit the payment of consideration to a journalist for

publishing, circulating or otherwise giving publicity to a security that is the subject of a pending or proposed offering by the issuer or an affiliate of the issuer. Such a rule should not prohibit payment for permissible advertisements that are clearly identified as such.

Registration Procedure

We agree with observations of the Advisory Committee and the Task Force that various aspects of the registration process under the Securities Act create unnecessary burdens and costs for issuers wishing to access the capital markets. We believe that many of these burdens and costs can be eliminated or reduced without compromising the investor protection afforded under the existing statutory scheme.

Remove the Unpredictability and Marketing Delays of Staff Review. The uncertainty and potential marketing delays resulting from the Commission's current policy regarding Staff review create pressure to issue securities in exempt transactions or in markets outside the United States and are too often principal factors in determining where to sell the securities. The Commission should eliminate Staff review of registration statements on Forms S-3 and F-3 and instead have Staff review concentrate on Exchange Act reports and on registration statements relating to initial public offerings. Some SIA members would go further and have the Staff review only Exchange Act reports and IPO registration statements. The Commission should also take steps to eliminate the unpredictability of and reduce the delay from Staff review of other Securities Act registration statements and of prospectus supplements relating to "novel" securities. At a minimum, the Commission should:

1. publicly announce the types of companies or transactions that are likely to be reviewed;
2. privately advise an issuer when its Exchange Act reports are being reviewed;
3. permit issuers to submit documents relating to a proposed transaction for confidential review in advance of filing;
4. implement faster review and approval of "novel" securities (see "New Product Development" below); and
5. publicly announce the types of "novel" securities that have been reviewed and, accordingly, are not subject to additional review.

"Pay-As-You-Go" Universal Shelf Registration. The Commission should permit a registrant to file, for a modest up-front fee, a universal shelf registration statement covering any securities issued by it or its subsidiaries, without specifying the class of securities and the issuer, and without paying the applicable registration fee, until the time of takedown.

Secondary Sales. The Commission should amend its rules, forms and administrative interpretations to permit the use of a universal shelf registration statement for secondary sales without naming the selling security holders until the takedown.

New Product Development. We strongly believe the Commission should foster innovation and strengthen the competitive position of the U.S. financial markets by facilitating the development

of new financial products. One effective way to do this may be to create a Special Branch, with members from each of the Divisions of Corporation Finance, Market Regulation and Investment Management, which would have responsibility for the prompt review of new financial products. This Special Branch should have an express mandate to facilitate new product development and should permit the confidential submission of documentation for proposed new products. Such Special Branch should also be the liaison with the Commodity Futures Trading Commission and the Board of Governors of the Federal Reserve System in appropriate cases.

Disclosure-Related Proposals

We support improvements to the content and quality of issuers' reports under the Exchange Act and meaningful methods of attaining that objective.

Disclosure Guidelines. We believe that one of the most effective ways for the Commission to improve the quality of disclosure in periodic reports is to provide more specific guidance to a greater number of issuers. While we strongly support Staff review of Exchange Act reports, the initial impact of such review is necessarily limited to the issuers that receive specific comments from the Staff. It is, of course, neither appropriate nor realistic for the Staff to review all issuers all the time. Thus, without more, the benefits of Staff review are necessarily realized by only a very limited portion of the market and are often disseminated in a manner which is, of necessity, both indirect and random to some extent. To maximize the benefits of Staff review and to assist more issuers in improving the quality and usefulness of their disclosures, the Commission should publish, after notice and public comment, specific guidance for various categories of issuers and businesses as to what is expected of them in complying with the disclosure requirements of the Federal securities laws and the regulations thereunder.

These guidelines could be developed on the basis of the Staff's experience in reviewing some issuers in specific businesses. We believe that this approach has been successfully utilized by the Commission in the past -- for example, we believe the Releases regarding the content of "Management's Discussion and Analysis of Financial Condition and Results of Operations" and various Staff Accounting Bulletins have had a beneficial impact on the quality of disclosures made by many companies. We strongly urge the Commission to utilize this approach more often and with respect to more subjects. We believe that such disclosure guidelines should be proposed for public comment before being issued in final form, in order to help ensure that the guidelines achieve an appropriate balance between the costs and burdens on issuers and the benefits to investors and the U.S. capital markets.

Limited Review of Interim Financial Information. We believe that requiring a limited review, by an independent professional, of any interim financial information included in a registration statement or report filed with the Commission would be a very practical way to improve the general quality of disclosure. The Commission should require that independent public accountants perform a limited review of such interim financial information of the kind contemplated by Statement on Auditing Standards No. 71 of the American Institute of Certified Public Accountants, as amended from time to time. Although this requirement may marginally increase the accounting expenses incurred by some companies that do not already have such reviews done on a timely basis, we believe that any additional costs would not be significant. Moreover, they would be fully justified by the overall benefits to investors of having independent reviews performed on a quarterly basis.

"Plain English" Summary in Prospectuses. We commend the Commission's initiative to encourage appropriate "plain English" disclosure in Securities Act prospectuses. We believe that in many cases the investing public would be well served by a "plain English" summary of the offering at or near the front of the prospectus. Such summary should, in appropriate cases, summarize in "plain English" the material risks (and potential benefits) of investing in the securities being offered. In addition, SIA would be pleased to pursue with the Commission ways to foster more user-friendly disclosure in prospectuses and other documents.

Safe Harbor for Forward-Looking Information. We believe the Commission should exercise its exemptive authority to broaden the classes of issuers and transactions entitled to the safe harbor for forward-looking statements provided by Section 27A of the Securities Act. In particular, we believe the safe harbor should be available in connection with tender offers and initial public offerings. The reasons for encouraging forward-looking statements are at least as compelling in these transactions as in those already covered by the safe harbor. Such reform would broaden the dissemination of information of special interest to many investors and would strengthen the competitive position of the U.S. capital markets.

Expanding Events Reportable on Form 8-K. The Advisory Committee Report recommends expanding Form 8-K to require the disclosure of (a) material modifications of the rights of security holders; (b) resignation or removal of any of the issuer's top five executive officers; (c) material defaults on senior securities; (d) sales of a significant percentage of the issuer's outstanding equity; (e) advice from the issuer's independent auditor that reliance on its audit report included in previous filings is no longer permissible because of the auditor's concerns about its report; and (f) the issuer's effort to engage another auditor to reaudit a period covered by a previously filed audit report. We support this proposal but, in view of its limited scope, do not expect that its implementation would affect significantly the overall quality of disclosure in periodic reports.

Shortening the Deadline for Filing Form 8-K Reports. In general, we support accelerating the date by which reports on Form 8-K must be filed with the Commission.

Risk Factors in Form 10-K Reports. We see both advantages and disadvantages to expanding Form 10-K to require disclosure of material risks of investing in the issuer's securities. On balance, we believe that the issues in this area could be more effectively addressed in the

manner described in "Disclosure Guidelines" above. In any event, we believe that risk factor disclosures should continue to be included in prospectuses under the Securities Act.

Officer Certifications of Exchange Act Filings. We believe that requiring the attestations described in the Advisory Committee Report is formalistic and is not likely to affect behavior or the quality of disclosure in any meaningful way.

Management Report to Audit Committee. We question the utility of a requirement to file with the Commission a management report to the Audit Committee regarding the issuer's procedures for assuring the accuracy of its Exchange Act reports and for detecting and deterring insider trading abuses. Although issuers may decide to adopt such procedures, the Commission should not mandate specific documentation. The filing of such documentation is likely to increase paperwork and may result in boilerplate of no real value to investors.

"Disclosure Committee" of Directors. We believe that the Commission should not encourage reporting issuers to form a "disclosure committee" of directors. A company may on its own decide that forming such a committee, and providing adequate support so that the committee can function effectively, would be the best way to enhance the quality of the company's periodic reports. For another company, such an approach may not be the most effective, or even an appropriate, way to assure the quality and integrity of its disclosure documents. In view of the uncertainty concerning what impact the "disclosure committee" approach would have on the potential liabilities under the securities laws of members of the committee and of the other directors, we expect that many directors would be reluctant to serve and that such a committee would wish to retain its own counsel. The additional layering of the disclosure process may or may not be appropriate for a particular company. We are concerned that encouraging this approach may create unfair implications for companies that for legitimate reasons (of which uncertain legal consequences may be only one) choose other ways to assure the truthfulness and completeness of their disclosures. At most, the Commission should list the "disclosure committee" technique as only one possible alternative which an issuer may consider.

"Speed Bumps". We do not support requiring a regulatory "speed bump" (for example, the filing of a report on Form 8-K) prior to offerings of securities. Such a requirement would create an artificial impediment for issuers that wish to access the capital market on a timely basis and would not provide any substantial benefit to the public.

Underwriters' Liability

The role and liability of underwriters should be addressed. This is an area in which reform is long overdue.

When the Securities Act was enacted in 1933, underwriters' liability was predicated on active involvement in the preparation of a registration statement relating to specifically identified securities to be sold in accordance with a specifically described plan of distribution.

Prospectuses were prepared with complete current information, and underwriters were in fact always the gatekeepers. The system worked this way for some 40 years, until the Commission adopted a series of changes designed to improve the efficiency of the capital-raising process, including, among others, the following:

- 1970 -- Form S-16 -- Short-form registration statement relying on incorporation of

Exchange Act reports by reference for required disclosure.

- 1982 -- Rule 415 -- Registration on Form S-3 (which similarly relied on incorporation of Exchange Act reports by reference) of securities to be sold from time to time with no required notice and cooling off period.
- 1992 -- Form S-3 amended to expand class of eligible issuers and transactions. Universal shelf registration -- Making it easier to sell common stock without prior notice to the marketplace.

These changes have succeeded in providing issuers quicker access to the public capital market at lower cost. At the same time, however, these changes have reduced the role of underwriters in the preparation of what (through incorporation by reference) constitutes the registration statement. Moreover, these changes allow certain issuers with shelf registration statements to use underwriters that will not slow them down in their efforts to access the public market by insisting on an opportunity to conduct "due diligence" as contemplated by Section 11.

The liability provisions of the Securities Act have not kept pace with the realities of the underwriters' role in offerings registered on short-form registration statements. A fundamental problem is that underwriters are still held responsible as gatekeepers although they no longer control the gates. They typically do not, and as a practical matter cannot, participate in the preparation of periodic reports under the Exchange Act. Moreover, their liabilities are measured by the accuracy and completeness of the registration statement as of the time they become underwriters, while the liabilities of issuers, signing officers and directors are measured as of the effectiveness of the registration statement or, if later, the filing of the latest annual report on Form 10-K. The cumulative effect of the changes referred to above requires as a matter of principle, fairness and logic that underwriters' liability be revised to reflect the new realities of the registration and security distribution processes.

More Equitable Standard for Short-Form Registration Statements. We believe that it is essential for the Commission to acknowledge that Section 11 is no longer realistic or equitable as it applies to underwriters in offerings registered on a short-form registration statement and that the role and liability of underwriters under the Securities Act need to be changed. We recommend that the Commission consider that, in the case of sales of securities registered on Form S-3, F-3, F-7 or F-9, the standard of liability of underwriters with respect to the contents of the registration statement be similar to the standard currently applicable with respect to "expertized" portions of the registration statement, *i.e.*, that underwriters are not liable if, at the time of sale, they had no reasonable ground to believe, and did not believe, that the registration statement contained any misstatement of material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading. The effect of this change would be to relieve the underwriters of the requirement, in establishing a defense, that they prove that they made a reasonable investigation. It would also be necessary to modify Section 12(a)(2) to provide that it does not apply to underwriters with respect to company-related information contained in such short-form registration statement. The Commission may wish to consider limiting these modifications to securities issued by a registrant that meets certain additional criteria (for example, has been reporting under the Exchange Act (or a Canadian equivalent) for a specified minimum period of time or has a specified minimum public float).

Safe Harbor for Certain Registration Statements. Alternatively, the Commission should adopt a new Rule 177 to provide a safe harbor for underwriters who perform certain tasks and meet certain other conditions in connection with registration statements on Forms S-3, F-3, F-7 and F-9. In general terms, the safe harbor should be based on underwriters' review of periodic reports and pursuit of any "red flags" suggested thereby. A proposed draft of such Rule is set forth in the Annex attached to this letter. The Commission may wish to consider requiring that the registrant meet additional criteria (for example, has been reporting under the Exchange Act (or a Canadian equivalent) for a specified minimum period of time or has a specified minimum public float).

Clarify Circumstances Affecting Underwriters' "Due Diligence" Investigation (Rule 176).

Rule 176 should be amended to include the following factors in the list of relevant circumstances in determining whether an underwriter's conduct constituted a reasonable investigation:

- how the securities were sold, including the timing of the offering process
- the issuer's reporting history
- the market capitalization of the issuer
- the extent of research coverage of the issuer
- the ratings (if any) of the issuer's securities by nationally recognized statistical rating organizations

In addition, Rule 176 should expressly provide that what constitutes "reasonable investigation" or "reasonable care" in the context of offerings on short-form registration statements is substantially less than in other registered transactions such as initial public offerings. In view of the limited scope of the revised liability standards under Sections 11 and 12(a)(2) and Rule 177 proposed above, these amendments of Rule 176 will be necessary whether or not such revisions are made or Rule 177 is adopted.

Indemnification. The Commission should expressly confirm that indemnification of underwriters is not contrary to public policy. We believe that this position should apply to all registration statements, but in any case should at least apply to registration statements of the type referred to in Rule 177 proposed above.

Settlement Process

We believe that it is important for the Commission to strengthen the clearance and settlement process. The existing requirement for physical delivery of a prospectus prior to or simultaneously with written confirmation of registered sales imposes substantial expenses and unrealistic burdens in the context of T+3 settlement. These expenses and burdens would be further exacerbated and could become unworkable, if registered transactions were to be settled on a T+1 basis. While we believe that a final prospectus or prospectus supplement should be prepared and filed in all cases, we believe the prospectus delivery requirement should be decoupled from the settlement process, *i.e.*, the requirement should be revised to permit transmission of hardcopy or electronic confirmations to purchasers before physical delivery of a final prospectus. This revision would relieve costly bottlenecks and thereby facilitate the settlement process. We believe that investors are adequately protected so long as the issuer's file at the Commission reflects all material developments at the time of oral or written

confirmation of sale and includes selling information (*i.e.*, the type of information that currently may be omitted from the registration statement at the effective date in accordance with Rule 430A) within a reasonable period after such confirmation.

We also believe that, to take full account, and full advantage, of the advances in technology and communications whereby "accessibility" to information provides effectively the same investor protection as physical delivery, the Commission should consider possible alternatives to traditional delivery in appropriate cases.

Advisory Committee Proposal

The Advisory Committee has performed a very important and valuable service for investors, issuers and all other participants in the U.S. capital markets. As is evident from our above comments, we share many of the concerns expressed in the Advisory Committee Report.

We believe, however, that it would not be worthwhile to create a voluntary parallel registration system. While some companies may support the idea of having the option of joining a company registration system, we believe that not many companies would actually opt in, few of those would opt in all the way, and having a voluntary system (including a voluntary pilot program) would provide very little benefit, if any, to investors and would resolve some problems for a very small percentage of issuers and transactions. Any such benefits would be disproportionately small in relation to the costs and time that would be involved in developing and implementing such system or pilot program and the burden that would be imposed on market participants in having to digest and adapt to further complication of the regulatory system. To the extent that disclosure enhancements are desirable, they should apply to all issuers, not just those that choose to join a voluntary program.

A mandatory version of the Advisory Committee proposal should not be adopted. We believe that the disclosure enhancements included in the proposal are not likely to improve the quality of periodic disclosures significantly and do not justify a radical departure from the Securities Act's focus on the capital-raising process. In addition, most of the advantages of a mandatory system can be achieved more simply and at less cost by implementing the changes suggested above in this letter (especially more flexibility in using shelf registration and Rule 144A and more predictability of and reduced delay from Staff review). Moreover, developing and implementing a mandatory system would raise a number of fundamental policy issues which would need further exploration and study. For example, we believe that, as a practical matter, it would be difficult to impose company registration requirements on non-U.S. issuers. This practical consideration raises various issues of fairness as between domestic and foreign issuers that need to be fully explored.

We are very concerned that the complications of attempting to implement a company registration system, whether voluntary, pilot or mandatory, would necessarily occupy a significant portion of the Commission's resources, time and attention and would inevitably result in the deferral and delay of other actions that should have highest priority on the Commission's agenda for the immediate future.

The Committee appreciates very much this opportunity to present our views. Should you have any questions, please feel free to communicate with the undersigned at 312-855-8778. Also, we would be happy to arrange a meeting between the Staff and members of the Capital Markets

Committee or its Capital Formation Subcommittee to explain our views more thoroughly.

Very truly yours,

Perry L. Taylor, Jr.
Chairman
SIA Capital Markets Committee ³

cc:

The Honorable Arthur Levitt, Chairman
The Honorable Steven M.H. Wallman, Commissioner
The Honorable Norman S. Johnson, Commissioner
The Honorable Isaac C. Hunt, Jr., Commissioner
Richard H. Walker, General Counsel, Office of General Counsel
Brian J. Lane, Director, Division of Corporation Finance
Anita T. Klein, Special Counsel, Office of Chief Counsel, Division of Corporation Finance
Richard R. Lindsey, Director, Division of Market Regulation
Barry P. Barbash, Director, Division of Investment Management

Footnotes

¹ The Securities Industry Association brings together the shared interests of more than 750 securities firms throughout North America to accomplish common goals. SIA members -- including investment banks, broker-dealers, specialists and mutual fund companies -- are active in all markets and in all phases of corporate and public finance. In the United States, SIA members collectively account for approximately 90 percent, or \$100 billion, of securities firms' revenues and employ about 350,000 individuals. They manage the accounts of more than 50 million investors directly and tens of millions of investors indirectly through corporate, thrifts and pension plans.

² The Capital Markets Committee received comments and suggestions from various other SIA committees, and this response has received the approval of SIA's Board of Directors.

³ This letter was prepared on behalf of the Capital Markets Committee by its Capital Formation Subcommittee, consisting of representatives of the following member firms:

The Chicago Corporation
CS First Boston Corporation
Goldman, Sachs & Co.
Inter-Regional Financial Group, Inc.
Lehman Brothers Inc.
Merrill Lynch & Co., Inc.
J.P. Morgan Securities Inc.
Morgan Stanley & Co. Incorporated
Nomura Securities International, Inc.
Salomon Brothers Inc

ANNEX

Re: Securities Act Concepts and Their Effects on Capital Formation -- File No. S7-19-96

Rule 177: Reasonable Investigation, Reasonable Grounds for Belief and Reasonable Care under Sections 11 and 12(a)(2) of the Securities Act -- Forms S-3, F-3, F-7 and F-9.

In connection with a registration statement on Form S-3, Form F-3, Form F-7 or Form F-9 and related prospectus and prospectus supplement (if any), an underwriter has conducted a reasonable investigation and has reasonable ground for belief for purposes of Section 11, and has exercised reasonable care for purposes of Section 12(a)(2), of the Securities Act of 1933 if:

(a) at or prior to the initial delivery of the securities being sold, the underwriter:

1. has reviewed the registration statement (including all amendments thereto and documents incorporated therein by reference) and prospectus and prospectus supplement (if any) insofar as they relate to the securities being sold;
2. has discussed information contained therein with the registrant's chief executive officer, chief financial officer, chief accounting officer or a person designated for such purpose by any such officer; and
3. has made inquiry into any circumstance which caused such underwriter to believe that the registration statement, as amended, or prospectus, as supplemented, contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading;

(b) at or prior to the initial delivery of the securities being sold, the underwriter has received:

1. a certificate of an executive officer of the registrant to the effect that, to the best of his or her knowledge after reasonable investigation, (x) the registration statement, as amended, and prospectus, as supplemented, do not contain any untrue statement of a material fact or omit to state a material fact required to be stated therein or necessary to make the statements therein not misleading and (y) since the dates of the information contained in such registration statement and prospectus, there have been no material adverse changes in the registrant's affairs that are not reflected therein;
2. a letter of the registrant's independent accountants with respect to the audited financial statements and any unaudited financial statements of the registrant included or incorporated by reference in the registration statement, as amended, or prospectus, as supplemented, of the kind contemplated by Statement on Auditing Standards No. 72 (February 1993) of the American Institute of Certified Public Accountants, as amended from time to time; and
3. letters of the registrant's and the underwriter's legal counsel substantially to the effect that nothing that has come to the attention of such counsel has caused such counsel to believe that the registration statement, as amended, or prospectus, as supplemented, contains an untrue statement of material fact or omits to state a material fact necessary in order to make the statements therein, in the light of the circumstances under which they were made, not misleading (which letters need not cover any financial statements or expertized portions of the registration statement); which, in each case, may be subject to such exceptions as do not relate to the material misstatement or omission; and

(c) at the time of the initial delivery of the securities being sold and at the time of any subsequent sale thereof by the underwriter as part of the distribution, the underwriter does not know of any untrue statement of a material fact in such registration statement, as amended, or such prospectus, as supplemented, or of any omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading.

In the case of securities that are offered and sold on a continuous or delayed basis, (i) the requirements of paragraphs (a) and (c) shall be deemed to be satisfied with respect to any sale of the securities made as part of the distribution if such requirements have been satisfied at the time of such sale and (ii) the requirements of paragraph (b) shall be deemed to be satisfied with respect to such sale if such requirements are satisfied as of a date not more than 12 months preceding the time of such sale and the documents explicitly covered by the required certificate and letters include the most recent post-effective amendment (if any) to the registration statement (other than any such amendment that includes or changes information with respect to the plan of distribution and does not effect a material change to other information in the registration statement) and the most recent annual report that is deemed to be incorporated by reference into the registration statement at the time of such sale.

An underwriter shall also be entitled to the benefits of this Rule if (i) at the time of sale of any of the securities by it as part of the distribution, it does not know of any untrue statement of a material fact in the registration statement, as amended, or the prospectus, as supplemented, or of any omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading and (ii) another underwriter participating in the same distribution has satisfied the requirements of paragraphs (a), (b) and (c) required to be satisfied at or prior to the initial delivery of the securities being sold in the distribution.

This Rule does not provide an exclusive means whereby an underwriter may conduct a reasonable investigation and have reasonable grounds for belief for purposes of Section 11, and exercise reasonable care for purposes of Section 12(a)(2), of the Securities Act of 1933 in connection with registration statements on Form S-3, Form F-3, Form F-7 or Form F-9. Failure to satisfy all the terms and conditions of this Rule shall not raise any presumption that an underwriter has not satisfied such statutory standards.