

EXPRESS LANE OR
TOLLBOOTH
IN THE DESERT?
THE SEC'S FRAMEWORK
FOR SECURITY ISSUANCE

*by Jennifer E. Bethel and Erik R. Sirri,
U.S. Securities and Exchange Commission**

In 1935, issuers registered \$913 million of securities in 284 issues with the nascent Securities and Exchange Commission (SEC). We know little about what went through the minds of treasurers of that day when they considered options for raising capital, but we can make some reasonable guesses. First, they were operating in a country that at the time did not have an “equity culture,” in that most companies’ equity holdings were concentrated in the hands of a few wealthy and financially sophisticated investors. The average person did not own common stock. Communication between issuers and investors was relatively simple and slow, at least by modern standards. Finally, the country was in the midst of a depression during which, half a decade before, the stock market had lost 50% of its value within a year.

* We gratefully acknowledge helpful discussions with Joe Babits, John Britt, Tamar Frankel, Stuart Gillan, Julie Hoffman, Barbara Jacobs, Anita Klein, Brian Lane, Patricia Miller, and Petros Tsigotis. The Securities and Exchange Commission, as a matter of policy, disclaims responsibility for any private publication or statement by any of its employees. The views expressed in this paper are those of the authors and do not necessarily reflect those of the Commission or its staff.

Contrast this with the setting of securities sales today. The market has risen in an almost unbroken stretch since the early 1980s. Investors are ebullient over the prospect of investing cash in more than 10,000 registered offerings annually. Table 1 lists the growth of offerings in the public markets over the past 18 years. Stock ownership, both direct and indirect, has never been more widely distributed, aided in part by the ease with which both professionals and non-professionals can access fundamental market information. Primary sources include the SEC's EDGAR system, which distributes about ten gigabytes of data (three million pages) per day through the Commission's Web site.¹ Secondary sources, including print, electronic, and televised forms, further reduce investors' costs of learning about offerings.²

Equally important, changes have occurred in the institutional market for new offerings. Bought deals, Internet road shows, and the preeminence of mutual funds and pension funds, and of foreign and other institutional investors are all factors not envisioned by the drafters of the Securities Act of 1933 (the Securities Act), the legislation that governs security issuance. Those authors could not foresee the financial landscape 65 years hence, nor could they have reasonably been expected to do so.

We argue that although the securities laws governing capital raising have tried to keep pace with these factors, their age is beginning to show in some areas. The ready availability of cheap and accurate information about large issuers has in part obviated the need for certain disclosure protections offered by the original statute. The rise of wealthy and financially sophisticated institutional investors has reduced the need to protect at least some purchasers. The Commission's response has been to try to create "express lanes" for certain new security issuances—those privately placed or publicly sold by large public companies. The other segment of the market, small public companies, has seen less deregulatory activity by the SEC, although the Commission in 1992 simplified the registration procedure and certain forms for the smallest public companies.³

A less charitable view of SEC policy, as reflected in a recent article by Yale law professor Roberta Romano, argues that rather than enabling the capital markets, the Commission continues to construct a proverbial "tollbooth in the desert" by requiring costly and unnecessary investor protections.⁴ Romano depicts the SEC as a monopolistic regulator, and proposes an alternative regulatory system in which state securities law is preeminent. Issuers are free to choose among regulatory regimes in the different states or, at their option, to remain under the federal regime.

This article examines the evolution of key features of the securities law for both the public and private markets, and analyzes recent examples of Commission policies toward large issuers.⁵ We also discuss a recent SEC Report and subsequent Concept Release that considers the deregulation of certain offers of securities that would effectively remove the distinction between the private and the public market for securities of large issuers.

BACKGROUND

The purpose of the registration provisions of the Securities Act is to protect investors in public securities offerings and reduce information costs through the disclosure of company- and transaction-specific information.⁶ The Act requires that all public offers and sales of securities be registered with the SEC unless they are exempt from registration. Congress determined that when specific disclosure requirements are not necessary or the general anti-fraud provisions are sufficient to protect investors, securities may be exempt from registration. Such exemptions may be issuer-based, such as certain securities issued by banks. The Securities Act provides two other broad transaction-based exemptions that a seller or issuer of securities may claim. The first exemption, under Section 4(1) of the Securities Act, allows owners of a security to sell it without registration if they are not issuers, underwriters, or dealers. So if, for example, an individual wants to sell a share of stock on an exchange, the trade is likely to be exempt from Securities Act registration. The second exemption,

1. Estimate from the SEC's 1999 Congressional Budget. Even before EDGAR came on-line in 1984, Disclosure Inc. reproduced and sold SEC filings for about \$0.15 per page.

2. These sources include *Barron's*, *Wall Street Journal*, *Money* (print), *First Call*, *The Motley Fool*, *Bloomberg* (electronic), and *Wall Street Week* and CNNfn (television). Specialized publications have arisen as well, such as *Red Herring*, a monthly magazine that caters to the world of high-tech initial public offerings.

3. In 1992, the SEC adopted several small business initiatives for companies with less than \$25 million in public float and annual revenues. See SEC Adopting Release No. 33-6949, 8/13/92.

4. Roberta Romano, "Empowering Investors: A Market Approach to Securities Regulation," Working Paper, Yale Law School, 1998.

5. For legal analysis of many of the issues presented in this article, see S. Choi, "Company Registration: Towards a Status-Based Antifraud Regime," *The University of Chicago Law Review*, 64, (1997). Choi proposes a registration scheme where a company's liability for misstatements and omissions depend on objective measures such as its market capitalization or trading volume.

6. In contrast to regulatory bodies in some states and foreign countries, the SEC focuses on the disclosure of information to investors or "truth in securities" rather than on investment merit.

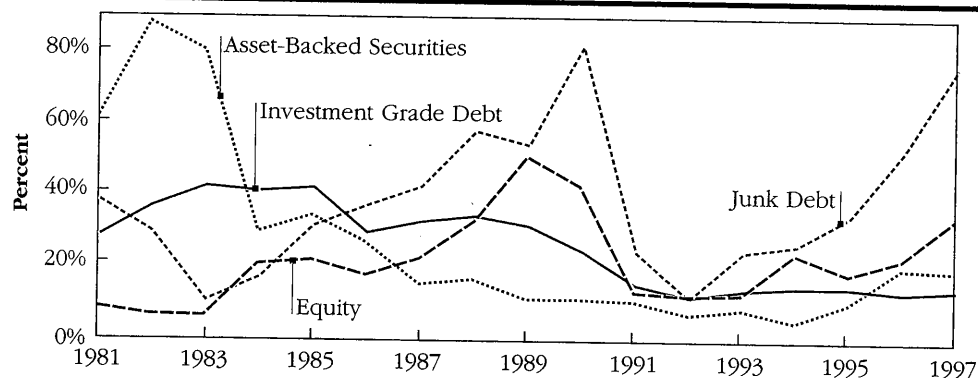
The Commission's response has been to try to create "express lanes" for certain new security issuances—those privately placed or publicly sold by large public companies.

TABLE 1 ■ PUBLIC CORPORATE SECURITIES OFFERINGS (IN \$BILLIONS)

Year	All Corporate Issues	CORPORATE DEBT								EQUITY		
		All Debt Issues	Investment Grade							High-Yield	Common	Preferred
			All Investment Grade	Non-Convertible				Convertible				
				All Non-Convertible	Mortgage Backed	Asset-Backed	Other					
1980	57.6	41.6	37.3	35.9	0.5	0.0	35.4	1.4	4.3	12.8	3.2	
1981	56.4	40.1	37.0	34.3	0.5	0.0	33.8	2.6	3.2	14.6	1.7	
1982	65.9	44.2	39.9	38.8	1.1	0.0	37.7	1.2	4.3	16.4	5.3	
1983	99.2	52.0	41.0	38.6	8.6	0.0	30.0	2.4	11.1	38.7	8.5	
1984	83.3	69.2	53.5	51.1	12.1	0.0	39.0	2.4	15.7	10.0	4.1	
1985	133.4	100.1	84.7	82.5	19.6	1.2	61.6	2.3	15.4	24.7	8.6	
1986	275.4	218.3	182.9	181.5	57.8	10.0	113.7	1.4	35.5	43.2	13.9	
1987	271.8	219.2	184.2	181.3	82.3	9.1	89.9	2.9	35.0	41.3	11.3	
1988	272.5	235.0	205.6	204.8	98.4	14.3	92.1	0.8	29.4	29.9	7.6	
1989	302.0	271.3	244.8	241.8	110.7	24.3	106.9	3.0	26.5	23.1	7.7	
1990	309.2	285.3	282.7	279.3	134.0	42.1	103.2	3.4	2.6	19.2	4.7	
1991	582.7	506.8	493.4	489.3	249.9	50.1	189.3	4.1	13.4	56.0	19.9	
1992	847.7	745.5	703.1	700.7	376.9	50.9	272.9	2.4	42.4	72.8	29.3	
1993	1,045.1	914.3	853.3	850.6	415.4	59.4	375.7	2.7	61.0	102.4	28.4	
1994	697.7	620.8	586.9	584.6	178.3	75.4	330.9	2.4	33.8	61.4	15.5	
1995	703.3	605.2	574.0	570.7	48.1	107.3	415.3	3.3	31.2	82.0	16.2	
1996	958.9	806.4	767.8	762.3	101.0	151.3	510.0	5.5	38.6	115.4	37.2	
1997	1,293.0	1,140.9	1,108.7	1,104.4	197.8	185.0	721.7	4.3	32.2	118.7	33.4	

Source: Securities Data Corporation. Company commitment offerings only. Excludes medium-term-notes.

FIGURE 1
PERCENTAGE OF CAPITAL RAISING ACCOUNTED FOR BY PRIVATE PLACEMENTS FOR VARIOUS TYPES OF SECURITIES



based on Section 4(2) of the Securities Act, allows companies to issue securities to investors who do not need the protection of the registration requirements of the federal securities laws. For example, issuers may not need to register offerings if buyers are financially sophisticated and thus can fend for themselves.⁷ In this instance, the seller "privately

places" the securities rather than publicly distributes them. Private placements make up a significant portion of U.S. capital markets. The market shares of private (unregistered) issues for four types of securities are shown in Figure 1.

Issuers that are not exempt must provide company- and transaction-specific information to the SEC

7. SEC v. Ralston Purina Co., 346 U.S. 119, 1953.

and investors. They are subject to liability under Section 11 of the Securities Act, which holds issuers "strictly liable" for losses to investors stemming from material misstatements and omissions. In addition, persons other than the issuer who are responsible for developing a prospectus, including corporate directors, accountants, underwriters, are encouraged to conduct a "reasonable investigation" regarding the quality of an issuer's disclosure. The penalty for omitted or false information is rescission; that is, investors may "put" securities back to an issuer at the offering price.^{8,9}

The Securities Act also specifies the timing and type of communications that may occur between an issuer and investors during an offering of securities. Limitations on communications were originally designed to prevent issuers from hyping securities, instead focusing investors' attention on the prospectus, whose contents were both specified and reviewed by the Commission. An issuer today is subject to a "quiet period" during which only "ordinary business communications" may be released. From the time an issuer first contemplates a securities sale until its registration statement is approved by the Commission (goes "effective") and it may begin the sale, the issuer must limit its communication with prospective investors. Sellers generally are permitted to release only prescribed information about an offering—such as a tombstone advertisement notifying the public of a pending security offering—before filing with the SEC. If a prospective issuer promotes the company more aggressively, it may be viewed as "conditioning the market" or "gun-jumping." If the violation is egregious, the SEC may require the issuer to delay its offering and allow the market to "cool off." After the registration statement is filed but before the Commission's staff declares it effective, an issuer may communicate, orally and in road shows, the contents of its prospectus but may not communicate in writing with investors (engage in "free-writing") except in the prospectus. The issuer may also gather "indications of interest" to buy, but may not sell the securities.

In addition to registering offers and sales of securities, public companies must file information with the SEC on an on-going basis under the Securities Exchange Act of 1934 (the Exchange Act). This infor-

mation includes annual reports on Form 10-K, quarterly reports on Form 10-Q, interim filings on Form 8-K, and other information releases. Companies and associated parties are liable under Rule 10b-5 of the Exchange Act for the quality of these disclosures. Rule 10b-5 allows investors to receive remedy in private litigation if issuers or associated parties knowingly misstate material information *and* investors rely on the misstated information when they invest.

SEC Rules and Initiatives: 1982

In the late 1970s and early 1980s, the Commission began to deregulate the public offering process for large seasoned companies. Before then, the SEC treated offerings by large and small issuers (those with market values less than \$150 million) essentially the same except for several pilot programs. At the same time it began to deregulate public offerings, the Commission started to reduce some of the regulatory uncertainty surrounding the raising of capital in the *private* market, thereby also facilitating its development.

The Commission adopted in 1982 what have been its most far-reaching regulatory changes to the public markets. The first change allowed large seasoned companies to incorporate information from Exchange Act reports "by reference." That is, instead of repeating company information that was mandated in both Exchange Act reports and registration statements, issuers could merely "incorporate" Exchange Act information in an offering's registration statement simply by referring the reader to previously disclosed information.¹⁰ By availing themselves of this option, issuers dramatically reduced the length of prospectuses, speeding offerings to market. A by-product of this development was that the substance of the Exchange Act reports incorporated by reference into registration statements became subject to liability under Section 11 of the Securities Act. This increased issuers' liability burden for failing to report information accurately.

The Commission predicated its adoption of incorporation-by-reference on the applicability of the efficient markets hypothesis to large seasoned companies.¹¹ The Commission limited use of incorporation-by-reference to companies that satisfied three conditions:

8. Issuers are also subject to liability under Section 12(a)(2). This liability is similar to liability under Section 11, except that liability under Section 12(a)(2) is not "strict," in that it provides sellers a possible defense. Sellers may defend themselves as having not known and having not been able to know about a material misstatement or omission.

9. Though an important investor protection, the first fully litigated decision interpreting the provisions of Section 11 did not come until 1968, 35 years after enactment of the Securities Act (*Escott vs. BarChris Construction Corp.*).

10. 17 CFR 239.0-1. See also American Law Institute, *Federal Securities Code*, 1980.

11. See SEC Proposing Release No. 33-6331, 8/18/81, p. 290.

While the Commission was deregulating the offering and registration process for public offerings by larger seasoned issuers, it was also reducing regulatory uncertainty for issuers selling securities in the private market.

(1) the aggregate market value of voting shares held by non-affiliate investors (public float) was greater than \$150 million, or greater than \$100 million if the annual trading volume in the company's shares exceeded three million shares; (2) the company had not defaulted on any debt, preferred stock or rental payments in three years; and (3) the company had met all Commission disclosure requirements in the previous 36 months.¹² In 1982, approximately 1,584 companies met the above criteria; 7,400 did not.¹³ These requirements began to divide the public market into two groups: larger seasoned and smaller new companies, a bifurcation that was to become more pronounced in the future.

On the same day, the Commission adopted Rule 415, which allows large seasoned companies to raise capital using shelf registration.¹⁴ In shelf registrations, firms first file a "core prospectus" specifying the type of securities (debt, equity, etc.) to be registered and the amount they "reasonably expect to be offered and sold within two years." Once the staff declares the core prospectus effective, the company may file "pricing supplements" that describe the exact terms of the securities to be "taken down" or sold. Given that the SEC requires supplements to be filed within two business days following pricing or first use (whichever is first), issuers face no staff review when they actually sell the securities.

Shelf registration increased eligible issuers' flexibility in both securities design and sales timing, and helped speed issues to market. Shelf registration also reduced issuers' direct costs by intensifying underwriter competition because companies were not required to specify underwriter participation until they filed a pricing supplement.¹⁶ But it is largely limited to companies that can incorporate information in Exchange Act reports by reference. Shelf registration has thus contributed further to a partition of the public market into large and small issuers.¹⁷

While the Commission was deregulating the offering and registration process for public offerings by larger seasoned issuers, it was also reducing regulatory uncertainty for issuers selling securities in the private market. As discussed above, companies can avoid registering securities with the Commission by selling them exclusively to financially sophisticated purchasers who do not need the protection of federal registration. Until 1982, however, the Commission provided little guidance as to what constituted a financially sophisticated purchaser. Instead, issuers relied on judicial precedents and Commission interpretation, which resulted in regulatory risk and uncertainty.¹⁸

In 1982, the Commission adopted Regulation D, which stated that, among others, individuals receiving annual income in excess of \$200,000 or whose net worth (with or without their spouse's) exceeded \$1 million would be considered "accredited investors."¹⁹ Companies could sell unregistered securities to an unlimited number of accredited investors and up to 35 non-accredited investors, provided the non-accredited purchasers (or their purchaser representative) were financially sophisticated.²⁰ This regulatory guidance facilitated the growth of the private market because issuers could claim, with considerably less risk, an exemption under Section 4(2) of the Securities Act from having to register securities. Regulation D broadened the investor base for private placements and allowed securities to be distributed to a wider population of buyers, thereby reducing issuers' capital costs.

Although the early 1980s were largely deregulatory, the Commission increased disclosure requirements under both the Securities Act and the Exchange Act. Beginning as early as 1970, for example, the Commission required multi-segment companies to report segment revenue and income in

12. In addition, companies could incorporate information by reference into prospectuses of investment grade securities, irrespective of public float. See SEC Adopting Release No. 33-6383, 3/16/82.

13. See SEC Proposing Release No. 33-6331, 8/18/81, p. 296.

14. 17 CFR 230.415. For details, see SEC Adopting Release No. 33-6383, 3/16/82.

15. *Ibid.*, p. 1333.

16. Early research documents reduced costs of capital from shelf registration. More recent studies, however, fail to find such savings after accounting for differences in the types of companies that use shelf. Among the more recent studies are D. Allen, R. Lamy, and G. Thompson, "The Shelf Registration of Debt and Self Selection Bias," *Journal of Finance*, 45 (1990); D. Denis, "Shelf registration and the Market for Seasoned Equity Offerings," *Journal of Financial Research*, 16 (1991); and D. Denis, "The Costs of Equity Issues Since Rule 415: A Closer Look," *Journal of Business*, 64 (1993).

Moreover, one consequence of firms' rapid market access, however, is that underwriters have less time to conduct due-diligence investigations in shelf than traditional offerings, which has purportedly diminished their certification role. Studies by Booth and Smith (1986) and Denis (1991, 1993), cited above, suggest that only the

best quality companies issuing primary industrial equity can use shelf registration. (J. Booth and R. Smith II, "Capital Raising, Underwriting, and the Certification Hypothesis," *Journal of Financial Economics*, 15, (1986).) A more recent study, however, find no evidence of a certification problem in nonunderwritten secondary shelf offerings. (See M. Jensen, C. Hudson, and M. Sullivan, "Should Managers Shelf Register Secondary Offerings?" *Quarterly Journal of Business and Economics*, 36 (1995).)

17. See SEC Adopting Release No. 33-6383, 3/16/82.

18. Between 1974 and 1980, the Commission adopted Rules 146, 240, and 242 to clarify the conditions for nonpublic offering exemptions. These rules, however, failed to provide a uniform definition of financial sophistication and left some inconsistencies (SEC Proposing Release 33-6339, 8/25/81).

19. See SEC Adopting Release No. 33-6389, 3/8/82. 17 CFR 230.501(a) lists other parties eligible for "accredited investor" status. In 1989, individuals earning joint income with a spouse in excess of \$300,000 were added to this category. See SEC Adopting Release No. 33-6825, 3/20/89.

20. Regulation D also requires that issuers notify purchasers that the securities have not been registered with the Commission and that they cannot be resold unless they have been registered or the resale is exempt.

their 10-K reports.²¹ Segment disclosure requirements rose again in 1976, when SFAS 14 forced companies to report each segment's assets, depreciation, and capital expenditures.²² In 1992, the Commission required companies to disclose much more information about executives' compensation.²³ And this trend has continued. In 1997, for example, the Commission required companies to report their sensitivities to market risks, including those induced by holding derivative securities, and further expanded segment reporting requirements.²⁴

We view the Commission's increases in on-going disclosure requirements as an attempt to balance the deregulation of public offerings and its investor protection mandate. The SEC significantly increased the flow of public information into the market. Having done so, it was willing to allow companies to go to market more rapidly and to include less information in their prospectuses. These benefits, of course, accrue primarily to investors and to large established issuers that raise capital in the markets frequently. The costs, however, are borne by public companies more generally. Firms that do not raise capital frequently bear the costs of the higher disclosure standards, but do not enjoy the benefits of rapid access to the capital markets.

SEC Rules and Initiatives: 1990-1992

A second deregulatory period began in 1990 and extended through the end of 1992. As with the changes in the early 1980s, the changes facilitated capital raising in both the public and private markets. The Commission continued to deregulate the capital-raising process for large seasoned companies, and to a lesser extent for small companies, thus further bifurcating the public market. At the same time, the SEC reduced regulatory uncertainty in the private market.

In 1992, the Commission relaxed the eligibility requirements for companies to incorporate information by reference into Securities Act registration statements: Companies needed a public float of \$75 rather than \$150 million, and 12 rather than 36 months of reporting

history.²⁵ The consequence of these changes was that 449 additional companies, or nearly 2,000 in total, were eligible to incorporate information by reference.²⁶

In addition, the Commission loosened its shelf registration requirements. Following the introduction of shelf registration, companies quickly began registering debt securities on shelves. By 1991, approximately 60% of the debt and preferred equity raised was registered on shelves. In contrast, issuers registered less than one percent of common equity on shelves.²⁷ The failure of common-equity shelves to flourish was due in part to issuers' fear of "market overhang"—the market's tendency to discount the value of a company's stock price when equity sits registered, but unissued, on a shelf.²⁸ The Commission responded in 1992 by permitting seasoned companies to register different types of securities in a single shelf-registration statement without having to specify the amount of each class of securities offered.²⁹ This innovation allowed issuers to combine common equity and other securities—including newly eligible investment-grade asset backed securities—on a single "universal shelf registration."

In 1990, the Commission also adopted Regulation S, which clarified the registration provisions for offshore placements.³⁰ As long as securities are sold and come to rest outside of the United States, and no efforts are directed towards selling to persons inside the United States, the Commission does not view an offering as being subject to U.S. securities laws. Regulation S facilitated the development of overseas markets by eliminating regulatory uncertainty for both domestic and foreign issuers.

In addition to deregulating the public offering process, the Commission in 1990 adopted Rule 144A to further develop the private-placement market.³¹ Before this change, purchasers of privately placed securities could not resell their securities under Rule 144 for two to three years unless the seller registered the resale with the SEC.³² The Commission, realizing that the holding period forced issuers to sell securities at substantial liquidity discounts, adopted Rule 144A to allow sophisticated financial institutions,

21. See SEC Adopting Release No. 34-9000, 10/21/70.

22. An industry segment is reportable if its revenue, operating profit or loss, or assets are 10 percent or more of the enterprise's combined industry segments (Original Pronouncements: Accounting Standards, FASB, 1994).

23. See SEC Adopting Release No. 34-6962, 10/21/92. See also 17 CFR 240.14a-101 and 17 CFR 229.402.

24. See SEC Adopting Release No. 33-7386, 2/10/97 and SFAS 131.

25. See SEC Adopting Release 33-6964, 10/29/92.

26. See SEC Proposing Release No. 33-6943, 7/22/92, p. 2053.

27. Ibid. Also see SEC *Annual Report*, and Denis (1991) for further discussion.

28. Previous research documents a 2-4% negative price effect for the two-day period when companies announce equity offerings. See, for example, R. Masulis and A. Korwar, "Seasoned Equity Offerings: An Empirical Investigation," *Journal of Financial Economics*, 15 (1986); W. Mikkelson and M. Partch, "Stock Price Effects and Costs of Secondary Distributions," *Journal of Financial Economics*, 14 (1985); and W. Mikkelson and M. Partch, "Valuation Effects of Security Prices and the Issuance Process," *Journal of Financial Economics*, 15 (1986).

29. See SEC Adopting Release 33-6964, 10/29/92.

30. 17 CFR 230.903. See SEC Adopting Release 33-6863, 4/24/90.

31. 17 CFR 230.144A.

32. See SEC Adopting Release No. 33-5223, 1/11/72.

In response to the SEC's adoption of Rule 144A, issuers flooded the private-placement market with securities because they could raise capital at rates more favorable than before, while avoiding the potential delays in staff review and the costs of registering securities in the public market.

TABLE 2 ■ PRIVATE PLACEMENTS: NON-RULE 144A (IN \$BILLIONS)

Year	All Private Placements	CORPORATE DEBT							EQUITY		
		All Debt	Investment Grade					High-Yield	All Equity	Common	Preferred
			Investment Grade	Non-Convertible			Convertible				
				All Non-Convertible	Asset-Backed	Other					
1981	17.6	16.1	14.2	13.7	0.8	13.0	0.5	1.9	1.5	0.5	1.0
1982	25.8	24.4	22.6	22.1	3.6	18.5	0.5	1.8	1.4	0.5	0.9
1983	33.7	30.7	29.5	29.2	4.2	25.0	0.3	1.2	2.9	1.4	1.5
1984	43.4	39.8	36.8	36.5	3.5	33.0	0.3	3.0	3.6	1.4	2.2
1985	75.2	66.1	59.2	58.8	6.2	52.6	0.4	6.9	9.1	6.4	2.7
1986	108.8	96.4	75.9	75.6	7.6	68.0	0.3	20.5	12.4	8.6	3.8
1987	127.7	112.8	87.4	87.0	11.8	75.2	0.4	25.4	14.9	10.5	4.3
1988	162.0	144.3	104.4	103.4	17.6	85.8	0.9	39.9	17.7	11.7	6.1
1989	171.1	139.7	108.7	108.4	13.3	95.1	0.3	31.0	31.4	22.0	9.4
1990	114.5	98.3	87.1	86.9	14.3	72.6	0.2	11.2	16.2	11.0	5.1
1991	79.3	71.9	68.6	68.3	17.5	50.8	0.3	3.2	7.5	5.5	1.9
1992	68.0	58.8	56.2	55.9	15.7	40.2	0.2	2.7	9.1	6.6	2.6
1993	82.5	72.9	71.1	70.6	30.2	40.4	0.5	1.9	9.6	7.4	2.1
1994	68.0	52.5	49.8	48.6	14.8	33.8	1.2	2.7	15.5	13.2	2.3
1995	61.3	46.8	44.9	44.6	17.0	27.6	0.3	1.9	14.5	13.1	1.4
1996	70.0	48.7	46.4	45.5	12.3	33.2	0.9	2.3	21.3	17.3	3.9
1997	93.6	56.2	53.7	52.6	17.5	35.2	1.1	2.6	37.3	33.6	3.8

Source: Securities Data Corporation. Agent-placed issues only. Excludes CDs.

designated as "qualified institutional buyers," or QIBs, to trade certain unregistered securities among themselves with no minimum holding period.³³

In response to this change, issuers flooded the private-placement market with securities because they could raise capital at rates more favorable than before, while avoiding the potential delays in staff review and the costs of registering securities in the public market. It has been estimated that 144A reduced the time to market to less than half of that of a registered offering.³⁴

The effect of Rule 144A and the dynamics of the private-placement markets can be seen by comparing Tables 2 and 3. Table 2 lists the amount of capital raised in non-144A private placements, while Table 3 shows the capital raised through 144A-eligible deals. The impact of Rule 144A on the private-placement market can be seen in 1990, when the market for ordinary private placements shrank, supplanted by Rule 144A-

eligible issuances. In 1991, securities sold in the 144A private market represented only two percent of the securities sold in the public markets.³⁵ By 1997, the 144A market had climbed to fully 20% of the amount of issuances in the public markets.

Figure 2 compares the portion of the private-placement market captured by 144A-eligible deals for four classes of securities. As shown in the figure, by 1997 the 144A market had all but subsumed the total market for high-yield debt and preferred stock.

CURRENT SEC POLICY ISSUES

Public Offerings

After several years of relative quiet, the Commission is again considering significant changes to the securities registration and offering process.³⁶ This reevaluation began in part with work by the Advisory Commit-

33. See SEC Adopting Release No. 33-6863, 4/24/90. Rule 144A specifies that securities may not be of a class of securities already traded on an U.S. stock exchange or quoted on NASDAQ. QIBs are defined to include financial institutions, corporations, and partnerships that own and invest on a discretionary basis at least \$100 million of securities. For more detail, see 17 CFR 230.144A.

34. See "In Search of a Perfect Market," *Investment Dealers Digest*, 6/9/97, p. 18.

35. See SEC Staff Report on the 144A Market, 7/20/94 and Securities Data Corporation.

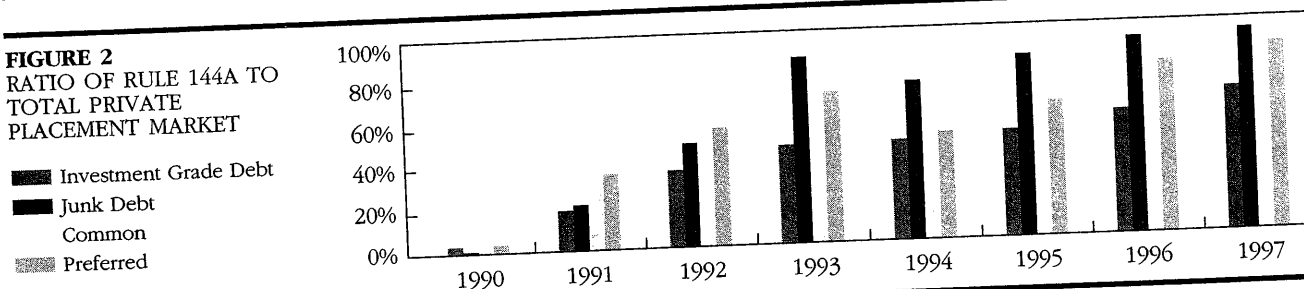
36. For example, see *Report of the Task Force on Disclosure Simplification to the Securities and Exchange Commission*, 3/5/96. The Task Force called for the elimination or modification of a quarter of the Commission's rules and half of its forms.

TABLE 3 ■ PRIVATE PLACEMENTS: RULE 144A (IN \$BILLIONS)

Year	All Private Placements	CORPORATE DEBT							EQUITY		
		All Debt	Investment Grade					High-Yield	All Equity	Common	Preferred
			Investment Grade	Non-Convertible			Convertible				
				All Non-Convertible	Asset-Backed	Other					
1981-89							0.1	0.2	1.2	1.0	0.2
1990	4.7	3.5	3.3	3.2	1.4	1.8	0.6	0.9	3.7	2.6	1.1
1991	20.9	17.1	16.2	15.6	2.6	12.9	1.2	2.6	5.4	1.9	3.4
1992	41.7	36.3	33.7	32.5	6.3	26.2	3.7	17.4	8.7	2.9	5.8
1993	91.0	82.3	64.9	61.2	7.0	54.2	2.3	9.2	8.1	5.5	2.6
1994	65.3	57.2	48.0	45.7	9.9	35.8	4.2	14.5	6.9	4.4	2.5
1995	71.2	64.3	49.9	45.7	10.9	34.8	3.5	40.5	23.1	4.3	18.8
1996	132.5	109.4	68.9	65.5	26.1	39.4	11.2	99.3	40.7	4.4	36.3
1997	262.0	221.3	122.0	110.8	42.6	68.1					

Source: Securities Data Corporation. Agent-placed issues only. Excludes CDs.

FIGURE 2
RATIO OF RULE 144A TO
TOTAL PRIVATE
PLACEMENT MARKET



tee on Capital Formation and Regulatory Processes (the Advisory Committee), chaired by Commissioner Steven Wallman, which searched for alternative regulatory models for the capital-raising process.³⁷ The Advisory Committee issued its recommendations in July 1996 in the form of a *Report* (the Advisory Committee Report).

The Advisory Committee recommended that the Commission replace the current transaction- and securities-based registration system with "company registration." First envisioned in 1966 and developed in detail in 1980,³⁸ company registration is a system in which public firms register as *companies* with the Commission on a one-time basis. When companies subsequently issue securities, they do not register them; instead they update their Exchange Act reports for material events that have occurred since their last filing and file any transactional information they deem necessary for investors. Because the *company* is registered and the staff has had the

option to review its Exchange Act disclosure, the company generally faces no additional staff review when it sells securities.

According to the Advisory Committee Report, only companies initially offering securities to the public and companies undertaking transactions that significantly alter their structures (so that existing information is "stale") must file Securities Act registration information. Under company registration, there would be no differences in the capital-raising requirements for large and small issuers. Public and private offerings would functionally be identical because there would be no resale restrictions on securities and all securities would have the same legal status and carry the same liability protection.

The Commission addressed these suggestions in its 1996 Securities Act Concept Release (the Concept Release).³⁹ The Concept Release raises important questions about the feasibility of com-

37. See *Report of the Advisory Committee on the Capital Formation and Regulatory Processes*, 7/24/96.

38. See M. Cohen, "Truth in Securities' Revisited," *Harvard Law Review* 79 (1966); and American Law Institute, *Federal Securities Code*, 1980.

39. See SEC Concept Release No. 33-7314, 7/31/96.

**The [SEC's] Advisory Committee recommended that the Commission
replace the current transaction- and securities-based registration system with
"company registration."**

pany registration and considers other ways to liberalize the offering and registration process. It considers alternatives based on investor sophistication, security type, and issuer type. For example, the Concept Release questions whether all investors need prospectuses physically delivered to them, or whether "access" might suffice for those that are financially sophisticated. The Commission also ponders broadening the definition of financial sophistication and questions whether Rule 144A should be expanded to include broader classes of securities. The Commission further asks whether it should accelerate the filing dates for Exchange Act reports and expand the types of events that trigger Form 8-K filings.⁴⁰ These questions, among others, suggest that the Commission may continue to deregulate the offering and registration processes, narrowing the distinction between sales in the private and public markets. They also suggest, however, that the SEC may demand more information on a continuous basis from companies as issuers gain quicker access to the capital markets.

The Internet

For both public and private offerings, advances in technology have forced the Commission to widen the scope of its regulation to accommodate the offer and sale of securities over the Internet. Web technology is such that absent special protections, overseas or domestic issuers that place offering information on a Web site cannot control or observe its viewership. Thus a foreign issuer that plans to sell securities in its home market and places information about its offering on the Web cannot guarantee that the information will not be viewed by U.S. investors. A literal interpretation of the Securities Act might require such an issuer to register its offering with the SEC because the Web site could be construed as a public securities offering to U.S. investors. Foreign issuers and their underwriters have requested assurances from the Commission that such postings would not be subject to U.S. securities laws. Similar concerns have also arisen with U.S. companies that sell securities either privately in the United States or overseas.

The concerns are well founded. In 1995, the United Kingdom's Security Investment Board (SIB) asserted jurisdiction over investment advertising accessible by U.K. citizens on the Web. U.K. law prohibits foreign persons from making investment advertisements "directed or available to" U.K. persons unless they register as advisors. Because Web sites of some foreign advisors were "available to" U.K. persons, they violated the letter of the law. The issue is all the more pointed because, unlike the SEC, the SIB is vested with criminal as well as civil authority. The specter of U.S. fund executives being hauled off to British jail was enough to give pause to U.S. funds that wanted to take advantage of Internet technology. The Financial Services Authority (the super-regulator successor to the SIB) has not yet issued guidance on the issue.

In March 1998, the SEC issued guidelines for both foreign and domestic issuers about how they can avoid violating U.S. securities law when using the Internet to promote and sell securities.⁴¹ The guidelines state that a Web site will not be considered an illegal offering of securities (or illegal investment advice, or promotion of exchange services, etc.) if the site includes "a prominent disclaimer making it clear that the offer is directed only towards countries other than the United States."⁴² The Web site must include protections "reasonably designed to guard against sales to U.S. persons" such as verification that a respondent's telephone number, e-mail address, or mailing address is not indicative of a U.S. location. Issuers would not be held liable for U.S. investors who, as respondents, attempt to disguise their identity by falsifying the information they provide issuers.

The same framework, with minor modifications, extends to issuers who wish to simultaneously sell offshore and domestically, pursuant to an exemption such as 4(2). To rely on such an exemption, issuers must not widely and publicly distribute information about an upcoming offering to generate U.S. investor interest. Using the same framework discussed above, the Commission provided guidance as to when a foreign issuer's Web information about a global offering would not trigger U.S. securities laws.⁴³ If the offeror is a U.S.

40. For domestic companies, annual reports on Form 10-K are due 90 days after the end of the fiscal year, quarterly reports on Form 10-Q are due 45 days after the end of the fiscal quarter, and "material events" reports on Form 8-K are due within either 5 business days or 15 calendar days after an event occurs, depending on the event.

41. *Interpretation, Statement of the Commission Regarding Use of Internet Web Sites to Offer Securities, Solicit Securities Transactions or Advertise Investment Services Offshore*, Release No. 33-7516, 3/23/98. The guidelines cover matters related to the Securities Act, the Exchange Act, the Investment Company Act of 1940, and the Investment Advisors Act of 1940.

42. *Ibid.*, at Section III(B).

43. *Ibid.*, at Section IV(a)2.

company, more stringent restrictions apply because U.S. investors might mistakenly assume that the full protection of U.S. securities laws apply to the offering, and because the securities are more likely to come to rest in the United States than if the issuer is foreign.

The Commission's decision reflects the institutional reality of the flow of public information. The technology used to transmit information does not recognize geographic or jurisdictional boundaries. Unless the SEC adopted an absolute prohibition on Internet communication, issuers and their agents needed regulatory clarification as to how they could avoid violating U.S. securities laws when using the Internet. A warning or disclaimer in the Internet notice, coupled with requirements that reduce the likelihood that an advertisement is a "back-door" attempt to solicit U.S. investors, is a reasonable and workable solution.

It is also consistent with the Commission's earlier rule regarding U.S. journalists' access to offshore press conferences.⁴⁴ Foreign issuers excluded the U.S. press from offshore press conferences out of fear of inadvertently making an "offer" of securities when they discussed financing activities with U.S. journalists. The U.S. press was forced to obtain information second-hand, resulting in delayed news to U.S. investors without additional investor protections. To remedy the situation, the SEC established a four-part objective test, which if satisfied would ensure that an issuer didn't illegally offer securities under U.S. law. The similarity of the press conference rule with the Internet rule lies in the notion that the SEC cannot eliminate or adequately control cross-border communication. Its best tactic is to create a low-cost "path of least resistance" into which issuers will be drawn, and to place investor warnings on distributed materials as to the intended audience or the inapplicability or limitations of U.S. securities laws.

Private Offerings

The Commission is also continuing to deregulate private offerings. Issuers will soon find it easier to sell private offerings. Congress passed the National Securities Markets Improvement Act of 1996 (NSMIA) which, among other things, forbids state regulators to require companies to register securities if they sell to "qualified purchasers." Under current securities regulation, companies that raise capital from the public

must generally register new securities with the Commission and with the regulators of states in which they sell if the securities are not listed on the NYSE, AMEX or NASDAQ National Market System. After NSMIA, securities sold to qualified purchasers—as defined by the Commission—will not be subject to state blue-sky registration requirements, regardless of their listing status. The Commission currently is working to define the term "qualified purchaser."

In 1997, the Commission also revised Rule 144. The original rule permitted investors to resell limited quantities of privately placed securities beginning two years after issuance, and to resell without limitation after three years.⁴⁵ The revision to Rule 144 allows investors to resell restricted securities' beginning one year after issuance, and to resell without restriction after two years.⁴⁶ In shortening the mandated holding period, the Commission hoped that investors would reduce the discount they demand for illiquid restricted securities, lowering companies' costs of capital and promoting the private market's growth.

Figure 3 summarizes our discussion of issuers' current alternatives for raising capital. As shown, a company may raise capital in either the public or private market. In the private market, a company may claim an exemption under Section 4(2) or use the safe harbor provided by Regulation D under 4(2). Depending on their identity, buyers may resell the securities pursuant to Regulation S, Rule 144A or Rule 144. Securities bought offshore may be resold to U.S. investors based on the guidelines provided in Regulation S; QIBs may freely resell securities among themselves under Rule 144A; and investors generally may resell securities after a sufficient holding period under Rule 144.

DISCUSSION

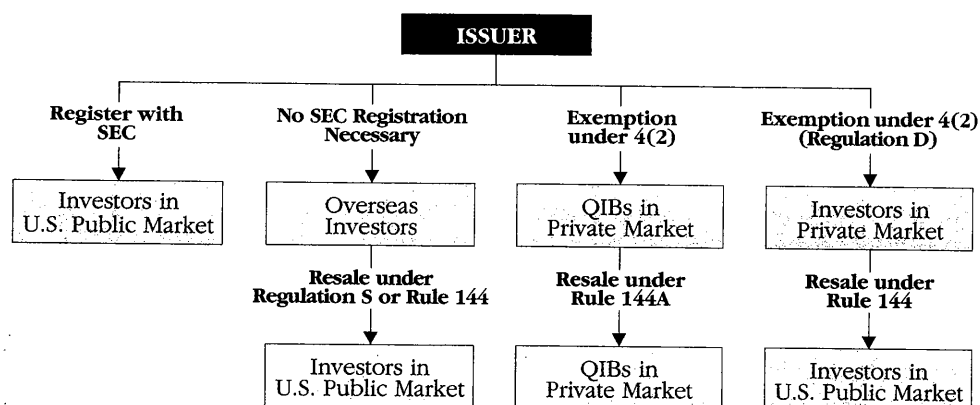
The SEC's primary mandate is to protect U.S. investors. To that end it strives to ensure that securities coming to market are accompanied by full and fair disclosure about the issuer and the security. The Commission, however, has long recognized that its disclosure requirements may be costly. Through the development of private-market registration exemptions and various public registration reforms, it has sought to provide capital-raising channels that lower issuers' costs and eliminate unwarranted security law protections for certain investors.

44. See SEC Adopting Release No. 33-7470, 10/10/97.
45. See SEC Adopting Release No. 33-7390, 2/28/97.

46. 17 CFR 230.144.

The SEC is now at a crossroads in its efforts to reach an optimal balance between investor protection through disclosure and cost to issuers.

FIGURE 3
PUBLIC AND PRIVATE
MARKET ALTERNATIVES
FOR RAISING CAPITAL



Note: In any of these alternatives, investors may freely resell their securities if the issuer registers the resale with the SEC.

The SEC is now at a crossroads in its efforts to reach an optimal balance between investor protection through information disclosure and cost to issuers. Congress helped formalize the Commission's tradeoff when it required in NSMIA that the SEC consider whether its rules promote efficiency, competition, and capital formation.⁴⁷ Arguably, the SEC registration regime works well: The U.S. capital markets are envied throughout the world for their depth, fairness, and liquidity. It would be a mistake, however, to attribute these traits exclusively to the regulatory regime. A contrarian might even argue that our markets have grown *in spite* of the SEC's imposed regulatory costs, though in our view this also is too polar a view.

The SEC faces a number of options at this point that, for expositional purposes, we can condense into two. Its first choice is one of maintaining the *status quo*. The SEC could continue to regulate the offer and sale of securities in much the same way it does today, adapting incrementally as change demands, but working largely within the transactional framework of the Securities Act.

There are numerous advantages to such an approach. First, it recognizes that the current system works well and has the compelling logic of not fixing something that isn't really broken. In such a regulatory environment, there are two distinct paths for large corporate issuers: the registered route, with its attendant information dissemination, strict liability

provisions, and cost; and the second path of *caveat emptor* afforded by the private market. By keeping two offering paths, the Commission ensures that issuers and investors have choices. Investors in public securities demand high-quality information about their investments and will pay in the form of higher security prices to receive it. The benefits of such a public market accrue not only to the prototypical individual investor, but to the marketplace as well. Mandated disclosure solves an important "public-goods" problem regarding the production of information. Without such disclosure, investors would have to produce information themselves, creating duplicative investor effort as well as a potential difficulty in capturing sufficient private benefits from costly private information gathering.⁴⁸

Similarly, issuers and investors in the private market enjoy benefits from a regulatory system tailored to their needs. Issuers concerned with speed to market and regulatory uncertainty may bypass the public markets, instead privately placing securities. QIBs, who may resell securities under Regulation 144A, would of course prefer more information to less. Yet they appear willing to purchase securities with the more limited disclosure of an offering circular and only the protections afforded by Rule 10b-5 instead of the stronger Section 11 "strict liability" criteria. Almost any unification of the public and private markets for

47. NSMIA states that, "whenever...the Commission is engaged in rulemaking and is required to consider or determine whether an action is necessary or appropriate in the public interest, the Commission *shall also consider*, in addition to the protection of investors, whether the action will promote efficiency, competition and capital formation." (NSMIA, Section

106(b), emphasis added). NSMIA provides no guidance regarding the relative weight the Commission should place on these factors vs. investor protection considerations.

48. See J. Hirshleifer, "The Private and Social Value of Information and the Reward to Inventive Activity," *American Economic Review*, 61 (1971).

large issuers that requires private offerers to enhance their disclosure or that imposes additional liability for disclosures would increase the costs borne by private-market participants.

In addition, the private markets serve as a kind of competitive check to the power of the SEC. As the all-in costs of registration rise, issuers will begin to opt out of the public and into the private market. The presence of a private-market alternative to the public market helps to balance what commentators like Romano have identified as a tendency of the SEC to behave as a monopolistic federal regulator. One limitation to this check, however, is that many of the costs of being a public company with the right to issue securities in the public market are on-going, rather than incurred at security issuance. Thus the marginal cost of issuing securities in the public markets at sale may be low, but only because the company has already paid many up-front costs in preparing its Exchange Act disclosures.

Even with the option of placing securities privately, issuers, investors, and others have noted that the current transaction-based disclosure regime in the public market has some shortcomings. From an issuer's perspective, the process of registering securities is slow and may inhibit the ability of companies to sell securities at precisely the time they need funds or at a rate they consider to be favorable. Shelf registration has partially addressed this concern as has the Commission's willingness to allow companies to incorporate Exchange Act information by reference. But, under SEC rules, Exchange Act disclosures that are not incorporated by reference into registration statements do not inherit Section 11 liability.⁴⁹ The result is that the quality of such disclosures may be lower than that of disclosures in registration statements.⁵⁰ And thus it may be problematic for the Commission to substantially increase its reliance on Exchange Act filings to protect investors, especially for firms that are ineligible or choose not to incorporate information by reference into registration statements.

Another concern is the impact of the 144A market on the foreign listings programs of the national exchanges and markets. To the extent that this quasi-private market has been useful for foreign

companies raising equity capital in the United States, these companies' issuance of privately placed ADRs may replace their need to list on U.S. exchanges and national markets. Because it is open only to QIBs, who predominate as buyers of foreign securities in this country, the 144A ADR market competes for national listings. Its success may pre-empt a portion of the listing growth opportunities for U.S. exchanges and public markets.⁵¹

A further problem associated with the private market's growth arises after the required two-year holding period when private issues become freely tradable under Rule 144. These securities are initially sold as private placements, with their terms crafted at the outset by a small number of purchasers who negotiate directly with the issuer. After two years, when the issues are freely tradable, the public market has little or no information about the securities and perhaps the issuer.

This is where the second main alternative, discussed in the Advisory Committee Report and the 1996 Concept Release, suggests a partial solution. It develops a schema whereby companies, and not their securities, are registered with the Commission on a one-time basis. Company information is kept current with a level of on-going disclosure more complete than exists today, with disclosures potentially having Section 11-like liability attach to them.⁵² The system would be available to issuers for non-IPO offerings provided they meet a set of conditions, including perhaps being current in their Exchange Act reports for a minimum period. In addition, it is possible that the quiet period during offerings could be eliminated, with companies freely communicating with investors (subject to liability for inaccurate statements). Prohibitions against gun jumping and conditioning the market would disappear. It is conceivable that the requirement of prospectus delivery could also be relaxed or eliminated. As discussed in the Advisory Committee Report, the Commission could require that certain investors have *access* to prospectuses rather than requiring their physical *delivery*, further deregulating the selling of securities and unifying the private and public markets.

It is natural to ask why the Commission has not taken such deregulatory actions earlier if they are

49. Exchange Act reports are also not subject to liability under Section 12 of the Securities Act.

50. See *Report of the Advisory Committee on the Capital Formation and Regulatory Processes*, 7/24/96. See also the comment letters to Concept Release No. 33-7314, 7/31/96 from Association for Investment Management and Research; Cleary, Gottlieb,

Steen, & Hamilton; Gary Kreider; Merrill Lynch; New York City Bar Association; New York State Bar Association; and PSA The Bond Market Trade Association.

51. See, for example, G. Sofianos and M. Kannan, "Non-U.S. Equity Issuers and the Rule 144A Market," Work-in-progress, 1998.

52. See SEC Concept Release No. 33-7314, 7/31/96.

One reason for adopting a non-transactional disclosure regime is that it recognizes the institutional realities of the marketplace. The private and public markets for securities of large issuers are effectively melded already.

beneficial for the capital markets. One reason is that the Commission's authority to make all the required changes was unclear. The passage of NSMIA expanded the Commission's authority to pursue reform by providing the Commission broad exemptive authority under both the Securities Act and the Exchange Act. It can now exclude companies from various portions of the Securities Act if doing so is in the public interest and consistent with the protection of investors. Such authority was required before the Commission could remove prohibitions against, for example, gun jumping and free-writing. In addition, NSMIA clarified the Commission's authority to change issuers' prospectus-delivery obligations.

There are several reasons why such a non-transactional disclosure regime may be preferable to the current framework. The first is that it recognizes the institutional realities of the marketplace. The private and public markets for securities of large issuers are effectively melded already. As pointed out by one industry commentator, you should "...get the idea of 144A as a private placement out of your head."⁵³ The securities trade in a highly liquid market, and the investment banks that underwrite them do so off their public desks. The market also has undergone a kind of *de facto* deregulation as the \$100 million securities size requirement for QIBs, first established in 1990, has not been indexed to the market's rise. In 1990 dollars, the minimum size for being a QIB has shrunk to between \$30 and \$50 million, depending on the asset class.

In addition, about one-third of issues packaged as 144As are sold with registration rights, further guaranteeing their liquidity. An example of this type of private-public hybrid goes by the industry parlance of "Exxon Caps," named after the company that first executed the strategy.⁵⁴ A company offers and sells a 144A-eligible security as a private placement. Immediately after sale, the company registers the security's resale with the Commission. Because the initial distribution is private, it happens quickly and without staff review. Registration then enhances the securities' liquidity. If an offering is reviewed or encounters registration difficulties, the company already has its capital in place and can negotiate

with the SEC staff over any concerns in subsequent weeks. Importantly, the staff's review cannot delay the capital-raising function. The initial institutional investors perform a function characteristic of a dealer: Issuers borrow "dealer" capital from institutions in the private placement. Institutions are later free to resell their securities, once registered, if they so choose.

A second reason such a non-transactional schema may be desirable is that by integrating the public and private markets, the SEC's ability to oversee the quality of information in the capital markets increases, enhancing investor protection. Private markets are exactly what their name suggests: opaque. Though investors who participate in them initially are financially sophisticated, the securities, lacking prescribed Commission disclosure, may eventually find their way into the public market, freely resellable. If the Commission can increase disclosure by integrating the private and public markets, investors may be better off. Such a result reflects a broadly held belief at the Commission that sunlight and scrutiny are generally good for the markets.

Finally, history suggests that the capital markets are wonderfully adaptive in their ability to assimilate regulatory change. At times, this works to the disadvantage of the Commission when the markets undo what the Commission seeks to accomplish. But more often than not, the marketplace develops financial products to suit investor and issuer needs. One example is the development of market-driven standardized disclosures for private placements. In a 1994 survey, 43% of the CFOs whose companies made 144A offerings stated that they used standardized offering documents. These evolved and became available only four years after Rule 144A was adopted.⁵⁵

Another example is the behavior of rating agencies. The Commission was concerned that Rule 144A would add liquidity to an opaque market, which, if it encouraged participation by large but ill-informed buyers, might work to the detriment of investors. Rating agencies, responding to the joint stimulus of enhanced trading interest and investors' demand for information, began rating 144A-eligible

53. Marty Fridson, chief high-yield strategist at Merrill Lynch, as quoted in "In Search of the Perfect Market," *Investment Dealers Digest*, 6/9/97, p. 23.

54. See Section 3(a)-9 of the Securities Act, and also "A/B exchange offers" in the Advisory Committee Report at Appendix A, p. 40. This strategy is limited to non-convertible debt securities, certain types of preferred stock, and initial offerings of common stock by foreign issuers.

55. Perhaps even more dramatic, though in a different setting, is the absolute preeminence of the ISDA master agreements in serving as the contractual basis for over-the-counter derivative transactions such as swaps and options.

offerings. The effort began with the smaller rating companies, Fitch Investors Services and Duff & Phelps, but later extended to larger raters.⁵⁶ In 1997, Moody's Investors Services and Standard & Poor's rated about 80% and 90%, respectively, of 144A-eligible private placements.⁵⁷

Not all market participants, however, necessarily welcome increased issuer speed to market. Underwriters, for example, complain that they are under pressure to rapidly review and certify offerings. Many note that shelf registration reduced their ability to conduct due diligence in quick offerings.⁵⁸ They feel that continued deregulation of the registration process and speeding offerings to market will further undermine their ability to influence the contents of issuer disclosure, leaving them liable for prospectus content. However, it is precisely this liability that will limit issuers' ability to rush underwriters' review of filings.

CONCLUSION

Over the last two decades, the SEC has removed many of the distinctions between the public and private markets for the securities of large issuers. It has done so by both broadening the class of investors who can hold and resell private securities and by streamlining the offering process of public securities. Options considered in the Advisory Committee Report and the Concept Release lead to the possibility that the Commission might someday move to a non-transactional disclosure regime. Such a system would likely require companies that regis-

ter with the Commission to provide significant amounts of on-going information, but allow them to provide less transactional information than they do today when they offer securities. Such a decision would be consistent with the Commission's deregulatory efforts over the past 20 years.

For many issuers, the reform would be welcome. The revisions discussed are largely deregulatory with respect to the public markets. Hence it is unlikely to meet stiff opposition from companies that currently file with the Commission. Detractors of the reform will almost certainly point to the possibility of decreased investor protection and its attendant problems. The likelihood that reforms would harm investors, however, will rest largely in the reform's details. The Commission has not yet proposed such a rule and thus such concerns are somewhat premature.

What is clear is that the U.S. capital markets continue to function well. But for any regulatory regime to be successful, it must meet the market test, which in this case means that it must be feasible in both up and down markets. With mutual fund assets recently reaching \$4.5 trillion, buyers for new securities have been plentiful and investors have not balked at investing in new securities because of disclosure concerns. As realized returns fall, as they eventually must, we may see a new balance between purchasers' demand for investment information and the amount that issuers choose to supply. A good solution by the SEC will be one that forecasts the nature of that balance and provides enough flexibility to adapt as technology and market structures change.

56. See "A Stiff Dose of Competition Transforms Private Placements," *Investment Dealers Digest*, 5/22/95, p. 55.

57. See "In Search of the Perfect Market," *Investment Dealers Digest*, 6/9/97, p. 18.

58. See also the comment letters to Concept Release No. 33-7314, 7/31/96 from Merrill Lynch; Morgan Stanley; PSA The Bond Market Trade Association; and the Securities Industry Association.

■ JENNIFER BETHEL

is the Chief Economist for the Division of Corporation Finance at the U.S. Securities and Exchange Commission.

■ ERIK SIRRI

is the Chief Economist of the U.S. Securities and Exchange Commission.