STATEMENT OF THE HONORABLE RAY GARRETT, JR.,
CHAIRMAN, SECURITIES AND EXCHANGE COMMISSION,
BEFORE THE SUBCOMMITTEE ON INTERNATIONAL FINANCE
OF THE SENATE COCMMITTEE ON BANKING, HOUSING AND
URBAN AFFAIRS ON S. 425, S. 953, S. 995 and S. 1303,
94th CONG., 1st SESS.

(July 22, 1975)

Mr. Chairman, members of the Subcommittee:

I am pleased to appear before this Subcommittee today to present the Commission's views on S. 425, "the Foreign Investment Act of 1975." With me this morning is Alan B. Levenson, Director of the Commission's Division of Corporation Finance, and Carl T. Bodolus, Chief of that Division's International Finance Office.

Although the Subcommittee will also be considering S. 953, S. 995 and S. 1303, which would grant the Secretary of Commerce certain powers with regard to foreign investment, I will generally restrict my comments today to S. 425, since only that bill relates directly to the jurisdiction of the Commission.

S. 425 was introduced in January of this year, by Senator Williams, and hearings on it were held last March, before the Subcommittee on Securities. S. 425 would, among other things, require increased disclosures about owners of more than five percent of the securities of publicly-owned corporations, and disclosure of all the beneficial owners of equity securities of a publicly-held company. Last March, when I testified on behalf of the Commission, I expressed our general support for the provisions of S. 425 that are aimed at improving the disclosure of equity ownership. We were -- and still are -- particularly troubled, however, with the provisions of S. 425 requiring disclosure of <u>all</u>

the beneficial equity owners of publicly-held companies and the burdens such a requirement likely would impose, without any commensurate benefit to investors.

Rather than repeat that testimony in full today, I request that a copy of my earlier testimony be included in the record of these hearings, along with a copy of the Commission's detailed written comments that were submitted to the Subcommittee on Securities in connection with its hearings.

When I last testified on S. 425, I stated that the Commission's staff was working on developing disclosure rules that would, if adopted, effect disclosure of some of the information that would be required by S. 425. I understand that the Subcommittee would like me to describe in more detail the status and nature of the rules our staff is considering, and highlight my earlier testimony briefly.

As you know, Section 13(d) of the Securities Exchange Act requires certain disclosures by persons who acquire the beneficial ownership of more than five percent of the equity securities of large, publicly-held American companies. S. 425 would amend Section 13(d) to require, subject to our rulemaking powers, that such a person also disclose his residence, nationality, and financial condition; the background, identity, residence and nationality of any associated persons who own equity securities of that issuer; and the background, indentity, residence and nationality of any other persons sharing or having exclusively the authority to exercise the voting rights of those securities.

While we have supported this provision of S. 425, it should be borne in mind that Section 13(d) of the Securities Exchange Act presently requires the disclosure of not only the information therein specified, but also

> "such additional information . . . as the Commission may be rules and regulations Prescribe. . . ."

This rulemaking authority is quite broad and open-ended, and could be used to promulgate rules requiring disclosure of the same information sought to be required by S. 425.

In fact, we are presently developing proposed rules under this existing authority. In this connection, last fall we held a Public Fact-Finding Investigation in the Matter of Beneficial Ownership, Take-overs and Acquisitions by Foreign and Domestic Persons. Our staff has generally concluded its review of the extensive record compiled during that public investigatory proceeding, at least with regard to certain questions relating to the disclosure of beneficial ownership.

As a result of that review, last May, the Commission received tentative and general staff recommendations concerning the appropriate use of our rulemaking authority, and these were, with some modifications, conditionally approved. Our staff is now in the process of developing detailed proposals for rule and form changes, and these proposals should be on our active docket by the end of August.

Subject to the time expenditures required by the Administrative Procedure Act's notice and comment provisions, and a review of the anticipated extensive and detailed public comments, these proposals are being given high priority, and their adoption, subject to whatever views we might receive, should be effected as expeditiously as possible, assuming that any proposals we publish are not preempted by legislation.

Among other things, we are considering proposing a rule defining the term "beneficial owner," for purposes of Sections 13(d) and 14(d). That definition would

focus particularly on the power to direct the vote of securities, to direct the disposition of those securities, and would also include persons with the right to receive certain economic benefits from the securities. In addition, we are considering rules making it clear that beneficial ownership could result from, among other things, certain family relationships.

Similarly, our staff is working on proposals which would require more disclosure of the nature of the beneficial ownership in Schedule 13D -- the form we require to be filed with us pursuant to Section 13(d). For example, disclosures might be required concerning the power of the person filing the statement to direct how such securities should be voted or, if such power is lacking, disclosures might be required of the situs of such power, as well as the nationality of the persons filing the form.

The definition of the term "beneficial ownership" under consideration is fairly broad. Presumably, it would encompass a number of financial institutions as well as individuals. For example, certain bank trust departments that serve as trustees, and certain broker-dealers who manage discretionary accounts, might be considered to be the beneficial owners of the securities held in the trusts or the accounts, respectively.

Rather than exclude such institutions from the definition of "beneficial owner," which might result in a definition that was too narrowly drawn, we are considering ways of alleviating some of the burdens that surely would devolve upon these institutions if our broad definition required them to file unnecessarily extensive disclosure reports. Section 13(d)(5) of the Act authorizes the Commission to promulgate a short form notice of acquisition, where the acquisition is in the ordinary course of business and is not made for the purpose, and does not have the effect, of changing or influencing corporate

control. A short form notice could be used by certain financial institutions to report their holdings, and we are considering rules to that effect.

These rules, if adopted in any form similar to what I have discussed, would in part accomplish the objectives contained in certain of the proposed amendments to Section 13(d). Perhaps the most significant rule, and the one most difficult to formulate, is one defining the term "beneficial owner" for purposes of Section 13(d). Whether or not S. 425 is adopted, there will still be a need for such a rule, since S. 425 does not presently contain such a definition. We are not contemplating proposing any rules, however, which would require all 5 percent owners of equity securities to file personal financial statements with the Commission, as S. 425 would require. When I testified before the Subcommittee on Securities I did not express our concern with this provision. Having considered it further, we do not believe it is necessary for the protection of investors when the acquiring person is not seeking control of the issuer. The public benefits would be too remote in such cases, the burdens of compliance too heavy, and the invasion of privacy unwarranted.

In addition to amending Section 13(d) of the Exchange Act to increase disclosure about owners of more than five percent of a class of equity securities, S. 425 also would add a new Section 14(g) to the Securities Exchange Act, creating a multi-tiered reporting procedure by record holders to issuers, so that American companies with a registered class of equity securities could obtain information to compile a list of the names, residences and nationalities of all the beneficial owners of such securities, as well as information with respect to the locus of authority to exercist the voting rights of the securities held of record by other persons.

Disclosure of beneficial ownership when separate from record ownership, however, is another matter. Under the present law there is no general requirement for such disclosure below the 5 percent level, nor is there any adequate means of enforcement against fiduciaries. We generally favor increased statutory authority in this direction.

As to creating a multi-tiered reporting procedure by holders of record, we agree with the objective of this provision, but believe that its scope and extent are not necessary for the protection of investors. The burden on nominees would appear to be excessive and the benefits to the pubic too remote.

However, we are considering a rule proposal that would require the issuer to disclose in its annual report filed with us, as well as in certain registration statements, the 30 largest holders of record of any class of voting security and the extent of their voting authority, if known to the issuer. If such proposal is made, it probably would exempt disclosures of very small holdings. Our staff is, in developing this proposal, taking into careful consideration the recommendations of an Interagency Steering Committee on Uniform Corporate Reporting, which, in cooperation with Senator Metcalf's staff, has developed a form of Model Corporate Disclosure Regulations (January, 1975).

There comes a point, of course, at which disclosure of ownership, when balanced against the need for such disclosure, becomes too burdensome, and constitutes an unreasonable and unnecessary invasion of personal privacy. In that regard, we have several problems with the solution proposed by S. 425.

We are concerned, for one thing, about the substantial costs that this proposed amendment would impose on brokerage firms, banks, trust companies and, especially

transfer agents, as well as the issuing companies, if the precise provisions of S. 425 were enacted, since the bill would apply to all beneficial owners, even the owner of one share of common stock. It is not unusual for a large company to have over 100,000 record holders of its common stock. AT&T has millions. So much data is too expensive to provide and more than anyone can effectively and properly use.

If the intention of this section of the bill is to elicit significant information regarding beneficial owners, the Congress should consider less burdensome, alternative means of accomplishing this goal. At the very least, the disclosure in filings should be limited, perhaps, to the 20 or 30 largest holders, or any holder of more than some percentage, such as 2 percent or 1 percent. This Subcommittee should be aware that many large companies with 50,000 or more record shareholders may have no more than three or four who own beneficially as much as one percent of the company's shares.

The problem in obtaining meaningful disclosure of stock ownership has always been the holding of record by fiduciaries who feel constrained, by law or custom or good business practice, from their point of view, to decline to disclose the identities of the persons for whom they hold the stock, except in response to legal process. Foreign fiduciaries, in many cases, will not even recognize our legal process for this purpose. Most fiduciaries will disclose the extent to which they hold shares for others but possess sole or joint voting power, but not the identity of the beneficial owner or of any other person who holds the power solely or jointly with the fiduciary.

The idea of requiring fiduciaires to disclose their beneficiaries, or at least those beneficiaries with voting power, on a regular basis for public filings raises other considerations that must be carefully weighed. One is the long-standing tradition and

policy in our law of protecting the privacy of private trusts. Compelling the public disclosure of the portfolios of private trusts -- even if only to the extent that they hold equity securities of publicly-owned U.S. companies for which the beneficiaries hold the voting power -- is a fundamental departure from our settled norms. Of course, we have long since made this departure where the beneficiary is a reporting person under Section 16 of the Securities Exchange Act or it is otherwise a control person, or affiliate, of the portfolio company, or one who has acquired five percent and becomes subject to Section 13(a). But the proposed Section 14(g) is a far-reaching departure.

One approach to the problems raised might be to require such disclosure only when the shares constitute more than a specified percentage of the outstanding shares, but making the percentage much lower than 10 percent or even 5 percent. One and two percent have been suggested with appropriate rulemaking power vested in the Commission. The theory, then, would be that an investor can preserve privacy through a personal trust and yet retain voting power so long as he keeps his positions in publicly-owned companies insignificant in terms of voting strength. Above that, public policy favoring disclosure will prevail over that favoring the privacy of personal investments.

Another consideration is one of competitive fairness among fiduciaries -- broker-dealers and trust companies and U.S. and foreign banks. The foreign part of the problem is not just one of even application of the law as written, but also as enforced. We have been engaged in long, and so far futile, efforts to compel disclosure of bank customers in some countries, even for purposes of criminal investigation. Here, S. 425 offers a device that might do the job, namely the judicial disenfranchisement or divestiture of the stock. S. 425, as presently drafted, would employ this device only for violations of the screening

provisions. We suggest that it be expanded to cover violations of the disclosure provisions, both foreign and domestic. Consideration should also be given to the impounding of dividends for non-compliance.

It is true companies have complained that they are sometimes unable to determine who actually owns their securities and thus cannot communicate effectively. We do not believe that the solution to this problem need be as all-encompassing as that proposed in S. 425. Pursuant to our new legislative mandates, our staff is considering ways to encourage or require that brokers who hold securities for their customers make sure that their customers receive issuer communications. We believe that this, in conjunction with a rule requiring issuers to provide sufficient quantities of material to brokers and others for their customers, will enable companies to communicate effectively with their shareholders.

S. 425 also would add a new Section 13(f) to the Securities Exchange Act, to require any foreign person, company or government to file with the Commission a confidential statement, containing certain specified information, thirty days in advance of any acquisition by which that foreign investor would own more than five percent of any class of equity securities of any United States company with more than one million dollars in assets.

The Commission would be required to transmit the pre-acquisition statement to the President, who would be authorized to prohibit the acquisition if he finds it necessary to do so in order to protect the national security, foreign policy of the domestic economy of the United States. An amendment to S. 425 has been proposed by Senators Williams

and Javits which would require the President to prohibit such an acquisition in certain instances, principally dealing with discriminatory conduct.

In my testimony last March, I voiced our concern that this proposed section might engender conflicts of interest within the Commission, with respect to our duties to require full disclosure, if we should receive nonpublic information pursuant to these provisions. For example, under this bill, the Commission could receive secret, but material, information regarding a proposed acquisition of equity securities of an issuer by a foreign investor while the Commission's staff is reviewing the adequacy of disclosures in a filing relating to a public offering of that issuer's securities or relating to corporate actions to be adopted by a vote of that issuer's security holders.

Accordingly, the Commission requests that, if the screening provisions of the bill are enacted, and the Commission is designated as the repository for the pre-acquisition filings, the Commission be authorized to require the publication of those reports if we find it necessary in the interests of investors.

Beyond, with respect to the substance of Section 13(f), as it would be amended by S. 425, and the other bills that you are considering here today with provisions for screening or otherwise controlling foreign investment in American companies we do not think it appropriate for the Commission to state a position.

Other than our interest in preserving the integrity and success of our capital markets, the Commission is not in any position to, and does not have any special expertise for, comment on the desirability of the screening process that would be established by S. 425, or on the powers relating to foreign investors that would be granted to the Secretary of Commerce pursuant to the other bills mentioned.

The Subcommittee no doubt recognizes, however, that any deterrent to foreign investments in the United States could have an adverse impact on the future ability of public companies to raise capital in the United States, and could impair the future depth and liquidity of trading markets in the securities of United States companies. Similarly, legislation of this nature could lead to the enactment of still more protectionist legislation by other countries which may impair the ability of United States companies to raise or invest capital abroad.

The Commission supported the enactment of the Foreign Investment Study Act of 1974. Presently, the Department of Treasury and Commerce are conducting an extensive study of foreign investments in the United States pursuant to that Act. An interim report from those Departments to the Congress is due on or about November 1, 1975, and a final report is due sometime around May 1, 1976.

In addition, by Executive Order of May 7, 1975, the President has established a Committee on Foreign Investment and directed the Commerce Department to obtain and analyze information on foreign investment in the United States. The Commission's staff is working closely with Commerce to increase the availability of information on foreign investment, and we expect the amendments to our rules which I discussed earlier to facilitate this effort.

If Congress determines that time permits, it may be appropriate to review the findings of the Commerce and Treasury prior to the enactment of any screening legislation in this area.

That concludes my prepared remarks. Messrs. Levenson, Bodolus and I would be happy to respond to any questions you may have.