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EARLY MANDATORY DISCLOSURE REGULATIONS

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Early Mandatory Disclosure Regulations*

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In a recent article in The Journal of Law and Economics, Jarrell elaborates on Stigler's 1964 examination of the effects of federal mandatory disclosure regulations.[1] In both of these works, the authors compare pre- and post-SEC[2] rates of return and associated risk of investing in new issues. The statistical results show only small differences in relative performance between periods[3]. These results have been viewed as contrary to the stated expectations of the advocates of Federal securities legislation who envisioned the federal disclosure requirements as a solution to reports of over pricing of pre-SEC new issues. Jarrell concludes "... findings indicate that the pre-SEC market for new equity issues was efficient, for the most part. The

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1 Jarrell, Gregg A., "The Economic Effects of Federal Regulation of the Market For New Security Issues", Journal of Law and Economics, Vol. XXIV, No. 3, December 1981, pp. 613-75. Stigler, George J., "Public Regulation of the Securities Markets", Journal of Business, Vol. 37, (1964), pp. 117-142.

2 The FTC administered the 1933 Securities Act for the year prior to the formation of the SEC.

3 Jarrell found, however, that fewer risky (high beta) new issues were available after 1933.

positive abnormal return performance is inconsistent with the view that the market in the latter 1920's was characterized by widespread overpricing of new equity issues."

The primary purpose of this paper is to suggest that the Stigler/Jarrell result should not be surprising even to those who believe that mandatory disclosure is important for the efficient functioning of capital markets.[1] As event analyses, both the Stigler and Jarrell efforts are probably incapable of addressing this general question because they selected an "event" bracketed on both sides by extensive mandatory disclosure requirements. Other sets of regulations prior to 1933, and prior to pre-SEC samples in the 1920s,[2] already provided for mandatory disclosure of most of the items specified in the 1933 Act. As a result, the Stigler/Jarrell findings are just as consistent with the proposition that pre-1933 mandatory disclosure regulations ameliorated serious efficiency problems in early 20th century capital markets as with the hypothesis that U.S. securities markets were naturally efficient up through the early 1930s.

Even assuming that mandatory disclosure is important to efficient functioning of securities markets, should the passage

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[1] Stigler and Jarrell do specify that their analysis is concerned with the effects of the SEC but make no effort to relate their findings to the earlier disclosure regulations. The same is true of their critics. For example, see Irwin Friend and Edward Herman's article "The SEC 'Through a Glass Darkly'," Journal of Business, Vol. 37, 1964, pp. 382-405. In short, early mandatory disclosure requirements have simply been ignored.

[2] Stigler used 1923-1928; Jarrell's sample stared with 1926.

of the Securities Act of 1933 have generated an expectation that market efficiency would be enhanced? A critical issue in developing such a prediction is whether or not there was a change in mandatory disclosures as a result of the legislation. Casual consideration of the levels of public commentary before and after the 1933 Act seems to imply that mandatory disclosure did increase with passage of the Act. There were numerous public statements about inadequate securities regulation before the 1933 Act and the number of such statements subsided after enactment of this legislation. More detailed consideration, however, suggests that intensity of the public commentary does not provide much information about the status of mandatory disclosure regulations.

The Commerce Department report for the hearings on the 1933 Act[1], for example, cited many complaints about obstacles to effective enforcement of state securities regulations. But, most of the complaints dealt with the difficulties in apprehending violators. None of the complaints claimed that relevant

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[1] "A Study of the Economic and Legal Aspects of the Proposed Federal Securities Law", Department of Commerce. Hearing before the House Committee on Interstate and Foreign Commerce on HR 4314, 73 Congress, 1st Session (1933).

financial information was unavailable per se.[1] In addition to the apparent lack of complaints about mandatory disclosures, review of disclosure requirements in effect prior to 1933 indicates that a great deal of information was subject to mandatory disclosure. Indeed, it is difficult to identify information required by the early SEC regulations that had not been required by other securities regulations before passage of the 1933 Act. With respect to exchange listed issues,[2] mandatory disclosure requirements were being adopted by the New York Stock Exchange and other exchanges before 1933.[3] With respect to railroad issues, the ICC began a mandatory disclosure program for railroads in 1920.[4] With respect to all types of issues, state blue sky laws contained numerous, elaborate, and constantly evolving

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[1] Federal securities regulations and creation of the NASD did address some of these enforcement issues, but more effective enforcement of blue sky laws would not, in general, be primarily a matter of disclosure. The securities laws in most states go considerably beyond disclosure concerns and address the "merit" of the issue apart from disclosure concerns. Indeed, changes in the enforcement and language of state securities regulations might explain Jarrell's finding that post depression issues included fewer high beta offerings. Available discussions of blue sky enforcement suggest that standards and enforcement were increased after the depression. See J.M. Edelman, Securities Regulation in the 48 States, Chicago: Council of State Governments, 1942, for a discussion and citations.

[2] Although Jarrell does not specify the proportion of his issues that were exchange listed, he does explicitly note the use of NYSE issues at page 630.

[3] See Benston, G.J., "Required Disclosure and the Stock Market: An Evaluation of the Securities Exchange Act of 1934," American Economic Review 63, No. 1 (March 1973) 132-55 at page 133.

[4] Jarrell included railroads in his sample as noted on page 627.

disclosure provisions considerably before the 1933 Securities Act.

Table 1, below, traces the evolution of listing requirements for the New York Stock Exchange. The initial steps toward mandatory disclosure were taken before the turn of the century, but the major industrial firms were forced to consider disclosure primarily after the closing of the unlisted section of the Exchange in 1910. The Committee on Stock List had growing success through individual listing agreements after that date. These individual agreements and the general policy directives of the Committee on Stock List produced increasingly detailed and frequent disclosures. By the time that the Federal Securities Acts of 1933 and 1934 were enacted, the New York Stock Exchange had listing requirements in place providing extensive disclosure. By the early 1930s, listing applications had to encompass 22 items of information including incorporation documents, descriptions of arrangements and agreements for distributing the issue, engineering and accounting reports certifying the nature of the firm's assets both financial and physical, an agreement to periodically report financial data and any major changes in the nature or status of the business subsequent to listing, and histories of the firm's capitalization efforts and operations.

For railroad securities, mandatory disclosure came as part of the Interstate Commerce Act of 1920. The ICC required an annual report for each railroad. The report became public as

Table 1

Partial Chronology of Disclosure Requirements of the New York Stock Exchange

1869	Committee on Stock List calls for disclosures of financial condition.
1870-1890s	Committee on Stock List requires statement of condition and a list of officers.
1900	Committee on Stock List begins a policy of seeking individual listing agreements that include disclosure items.
1910	Exchange closes its Unlisted Department. Most firms apply for listing on the Exchange.
1910s	Committee on Stock List obtains periodic financial reporting agreements and initial offering disclosure agreements from most firms. Compliance is greatest among newer and smaller firms. Some large and long established firms resist.
1934	Quarterly earnings statements become a common part of listing agreements.
1926	Increased detail in financial reporting is required.
1927	Separate depreciation accounts are required and depreciation policies established.
1928	Exchange requires outside audits.
1930	Listing agreements include pledges to supply "any reasonable" information requested by the Exchange.

Sources: Leffler, George L. and Loring C. Farwell, The Stock Market, New York, New York: Ronold Press Co., 1963, pp. 138-47; Shultz, Birl E., Stock Exchange Procedure, New York, New York: New York Stock Exchange Institute, 1936; New York Stock Exchange Listing Requirements: New York, New York: New York Stock Exchange, 1934; New York Stock Exchange listing applications of Nevada Consolidated Copper Company (1910), Pierce Oil Company (1920), and General Theater Equipment, Inc. (1930). These materials were assembled by archivists of the New York Stock Exchange.

soon as it was filed with the Commission.[1] The form for the annual report was furnished by the Commission and called for considerable detail. For instance, the 1920 form contained coverage of 591 areas of each railroad's operations and finances.[2] These included investments in the obligations of other firms, depreciation policy and accounts, stock and bond issues, profit and loss statements, sources of revenues, and detailed listings of physical assets and financial obligations.

Turning to state disclosure standards, Table 2 shows the disclosure provisions of the state securities regulations relative to the standards provided in the 1933 Securities Act. The state disclosure provisions recorded in Table 2 were those in effect in 1920, more than a decade before the 1933 Act.[3] Notations are made where statutes were revised between 1921 and 1933. Some of these revisions were initial enactments increasing the geographic spread of state disclosure regulations. Others provided changes in exemptions or specific types of issues covered.

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[1] The exemption of railroads from SEC disclosure requirements, mentioned by Smith ("Comments on Jarrell," Journal of Law and Economics, Vol. XXIV, No. 3, December 1981, pp. 677-86), can not be seen as a decision that the railroads should not have to disclose financial data. Rather, the exemption recognized that the long standing ICC annual reports already provided disclosure.

[2] "Annual Report of the Blythville, Leachville, and Arkansas Southern Railroad Company to the ICC for the year ending December 31, 1920," file 56A479 12/34:42-3-4 #1007.

[3] 1920 also predates Jarrell's sample period. This provides some assurance that the State regulations noted in Table 2 were operational and well established by the time Jarrell's issues were being floated.

Table 2

State Disclosure Requirements as of January 1920

Provisions of the 1933 Act[1] and the Date of the Initial State Laws

	206	207	208	209	210	211	212	213	214	215	216	217	218	219	220	221	222	223	224	225	226	227	228	229	230	231	232	233	234	235	236	237	YR
AL	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X		X				X	X	X	X	X		X	X		19
AZ	X	X	X				X	X	X		X	X	X	X	X	X	X	X		X					X	X	X	X		X	X	X	12
AR[2]	X	X	X				X	X	X					X	X	X	X	X		X					X	X		X		X	X		15
CA	X	X	X				X	X	X			X		X	X	X	X	X		X					X	/		X		X		X	13
CO[3]																																	23
CT[4]								X				X													X	/							11
DE[5]																									X								31
FL[6]	X	X	X					X	X		X	X	X												X						X	X	13
GA[7]	X	X	X	X	X	X	X	X	X			X	X	X	X	X	X	X		X					X	X		X		X	X	X	17
ID	X	X						X	X		X	X	X												X							X	13
IL		X	X	X	X	X	X	X	X		X	X	X	X	X	X	X	X		X					X	X		X		X	X		17
IN	X	X					X	X	X		X	X	X												X	X						X	20
IA[8]	X	X	X	X	X	X	X	X	X		X	X	X	X	X	X	X	X		X					X	X		X		X	X	X	15
KS[9]	X	X	X	X	X	X	X	X	X	X	X	X	X											X	X	X					X	X	11
KY[10]	X	X	X				X	X	X		X	X	X	X	X	X	X	X		X					X	X		X			X	X	20
LA	X	X	X				X		X		X	X													X						X	X	12
ME[11]	X							X	X		X	X	X	X	X	X	X	X		X					X	X		X		X			13
MD																										X							20
MA[12]																																	21
MI[13]	X	X	X				X	X	X		X	X	X	X	X	X	X	X		X					X			X			X	X	15
MN[14]	X	X	X				X	X	X		X	X	X	X	X	X	X	X		X						X		X		X	X	X	17
MS	X	X	X	X	X	X	X							X	X	X	X	X		X								X		X	X	X	16
MO[15]	X	X	X				X	X	X		X	X	X												X	X					X	X	13
MT	X	X	X				X	/	X		X	X	X	X	X	X	X	X		X					X	X		X		X	X	X	11
NE[16]	X	X		X			X	X	X		X	X	X	X	X			X		X					X	X		X		X	X	X	17
NV																																	
NH[17]																																	17
NJ																																	13
NM[18]																																	21
NY[19]																																	21
NC[20]	X	X			X	X		X	X		X	X	X	X	X	X	X	X		X					X			X		X	X	X	11
ND[21]	X	X		X	X	X	X	X	X	X	X	X	X	X	X	X	X	X		X				X	X	X	X	X			X	X	13
OH[22]		X	X	X			X	X	X		X	X		X	X	X	X	X		X					X	X		X		X	X		13
OK[23]	X	X	X	X	X	X	X	X	X	X	X	X	X											X	X	X	X				X	X	19
OR	X	X		X			X	X	X		X	X	X	X	X	X	X	X							X	X		X		X		X	15
PA[24]																																	17
RI[25]								X	X		X	X	X												X								10
SC	X	X	X	X	X	X	X	X	X		X	X	X												X	X					X	X	15
SD	X	X	X	X	X	X	X	X	X		X	X	X			X									X	X					X	X	13

Table 2 (Continued)

Provisions of the 1933 Act[1] and the Date of the Initial State Laws

	206	207	208	209	210	211	212	213	214	215	216	217	218	219	220	221	222	223	224	225	226	227	228	229	230	231	232	233	234	235	236	237	YR
TN[26]	X	X	X		X	X		X	X		X	X	X	X	X	X	X	X		X					X			X		X	X	X	13
TX[27]	X	X	X	X			X	X	X		X	X	X	X	X	X	X	X		X					X			X		X	X	X	13
UT[28]	X	X		X	X	X	X		X		X	X		X	X	X	X	X		X					X	X		X		X		X	19
VT[29]	X	X						X	X		X	X	X												X	X					X	X	17
VA[30]	X	X	X	X	X	X	X	X	X		X	X	X	X	X	X	X	X		X				X	X	X		X			X	X	16
WA[31]																																	23
WV[32]	X	X	X	X	X	X	X		X	X	X	X	X	X	X	X	X	X		X				X	X	X	X	X		X	X	X	13
WI[33]	X	X	X		X	X		X	X		X	X	X	X	X	X	X	X		X					X	X		X		X	X	X	13
WY	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X		X				X	X	X	X	X		X	X	X	19

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1933 Act Provision No.	Disclosure Item
206	Name of Issue
207	State Where Organized
208	Location of Main Office
209	Directors' Identification
210	Underwriters Identification
211	Major Holders (10%)
212	Size of Holdings by Major Holders
213	Business Description
214	Current Capitalization
215	Vol. of Options Outstanding
216	Capital Stock by Class of Stock
217	Current Debt Information
218	Uses of Funds Being Raised
219	Payments to Directors
220	Net Proceeds of Issue
221	Price of Issue
222 & 233	Payment to Underwriters
223	Non-Commission Expenses
224	Prior Issue Net (2 yrs.) Proceeds
225	Prior or Anticipated Payments to Promoters
226	Payments to Vendors made with Securities
227	Stake of Insiders in Recent Acquisitions
228 & 234	Counsel Identification & Opinion of Issue

(footnote continued)

Table 2 (Continued)

(footnote continues)

1933 Act Provision No.	Disclosure Item
229	Contingent Contracts Assoc. with Issue
230	Assets & Liabilities (Intang. Separate)
231	Profit and Loss Statements
232	Profits & Losses of Any Firm Acquired with the Proceeds of the Issue
235	Copy of Contingent Contracts
236	Charter
237	Copy of Issue (Underlying Agreements)

2 New statute in 1927.
3 First statute in 1923 included extensive disclosure.
4 New statute in 1930, continued to apply only to oil, gas and mining issues.
5 First statute in 1931. Primarily a fraud statute.
6 New statute in 1931.
7 New statute in 1933.
8 New statute in 1929.
9 New statute in 1929.
10 New statute in 1932.
11 New statute in 1923.
12 First statute in 1921 included disclosure items.
13 New statute in 1923.
14 New statute in 1926.
15 New statute in 1929.
16 New statute in 1929.
17 New statute in 1926.
18 First statute in 1921 included disclosure items.
19 First statute in 1921. Primarily a fraud statute.
20 New statute in 1925.
21 New statute in 1923.
22 New statute in 1929.
23 New statute in 1931.
24 New statute in 1923 primarily regulated brokers.
25 New statute in 1923 included major increases in disclosure.
26 New statute in 1932.
27 New statute in 1925.
28 New statute in 1925.
29 New statute in 1932.
30 New statute in 1928.
31 New statute in 1923 provided disclosure requirements.
32 New statute in 1925.
33 Substantially revised on several occasions.

All in all, the revisions altered the geographic pattern of specific disclosure and other regulatory requirements, but did not alter the fact that failure to disclose considerable financial data to the states would foreclose substantial parts of the potential market to the offerer.[1]

It should also be noted that several States had disclosure provisions reaching considerably beyond the specific requirements of the 1933 Act. For example, the original Kansas Law, and those modeled after it in Alabama, North Dakota, Oklahoma, Virginia, West Virginia, Wisconsin, and Wyoming, all had a clause requiring disclosure of _any_ inside information that might influence the value of the issue.

As Table 2 discloses, the 1933 Securities Act did not, with very few exceptions, result in mandatory disclosure of information that was not already required in publicly available reports to several state securities commissions. Some might object, however, that several states did not have disclosure laws, for example New York. While this is true, it would only be those issues that limited their distribution activities to these non-disclosure states that could avoid disclosure requirements. This would be a substantial narrowing of the potential market for the security. It is consequently difficult, without assuming limited distribution activities or stringent geographic markets

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[1] For a discussion of the ebb and flow of blue sky laws see Adelman (previously cited) and Louis Loss and Edward Cowett, _Blue Sky Law_, Boston: Little Brown Company, 1958.

for securities information,[1] to characterize the 1920s as being a period prior to mandatory disclosure and registration.

In conclusion, both pre- and post-SEC periods used by Stigler and Jarrell had mandatory disclosure. All that can be said in comparing post-SEC periods to the 1920s is that Federal disclosure regulations were appended to an extensive and evolving system of extant State, Federal, and exchange disclosure requirements. The Stigler/Jarrell results are certainly consistent with the proposition that the SEC disclosure requirements did very little to enhance market efficiency. Their results are similarly consistent with the suggestion that mandatory disclosure, in general, had little effect. But, since their pre-1933 data all came from years in which mandatory disclosure requirements similar to the SEC's were already in effect, their findings cannot preclude the possibility that securities markets were inefficient before the advent of ICC, State, and stock exchange

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[1] A separate argument might be made that although information was available, it was not provided as a matter of course in the same way it is under current regulations. This is quite a different question from ability of firms and insiders to exclude others from access to financial information. For the weak form of the efficient market perspective, simple public availability of information is considered enough disclosure since actions by even a few investors can be enough to move the market to reflect the information. The question of equity in access to public information is, consequently, more likely to be an issue of distribution and investor initiative rather than of efficiency.

mandatory disclosure regulations.[1] Hence, advocates of mandatory disclosure should not be expected to recant because of the Stigler/Jarrell results and critics of mandatory disclosure should be cautious in generalizing from these results.

To avoid the ambiguity in the Stigler/Jarrell results and to examine the effects of mandatory disclosure in general, the researcher, who wants to use U.S. nationwide data, would have to utilize a base period prior to the era of the blue sky laws. This would require using data from before 1911, the date of the adoption of the Kansas blue sky law. Such data would also predate most of the exchange requirements and the I.C.C. disclosures. Alternatively the researcher could limit his examination to non-railroad issues that were not exchange listed and that avoided registering in States with mandatory disclosure requirements.[2] Unfortunately, both data from before 1911 and data on early registrations and prices of non exchange-listed issues are very limited.

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[1] The Stigler/Jarrell findings are also consistent with other hypotheses. For example, changes in State laws and State enforcement of securities laws were taking place at the same time as enactment of the 1933 Act. Hence, the changes in state policies could also be the cause of observed changes. Alternatively, Federal disclosure requirements and enforcement might be acting as a substitute for State disclosure regulation. If so, the Federal requlations would not be expected to yield any net effects, but markets would still be more efficient than they would have been with declining State disclosure enforcement and static Federal activity.

[2] A pattern of avoiding registering in states with mandatory disclosure regulations could itself be a type of disclosure that would complicate this approach.