

made for depreciation due to wear and tear so the value of the assets will not be overstated.

Usually, gross fixed assets are carried at cost, although such cost usually will be different than the sum for which they could be sold.

An increase in fixed assets is the expected companion of expansion and increased sales. Also, an additional investment in equipment may be made, or new plants built, to cut costs.

If a large gain in fixed assets is not followed by a more or less corresponding gain in sales, management may have overestimated the ability to sell a larger volume of goods, or the industry may have reached overcapacity. However, if a company's fixed assets show little change for several years during a period of expanding business, the stockholder may have reason to worry about the company's competitive position or about management's keeping up with technological changes and innovations. A company often will tell you in the annual report that an addition has been made to its plants which will provide so many feet of additional floor space, and that a new warehouse has been acquired, or new equipment is being installed at a plant for the production of a new product.

Your Company's capital expenditures (outlays for new plant and equipment) amounted to \$11.6 million, and during the year a provision for depreciation of \$2.6 million was made for wear and tear. Gross fixed assets, which include land, show an increase of \$11.8 million.

The accumulated depreciation reserve also may be for obsolescence and may include an estimated amount for loss of value due to technological and other changes. Oil and gas and mining companies, as well as other natural resource enterprises having what are known as "wasting assets," also provide for depletion.

It would be fine if a company could continually produce and sell more merchandise, or mine more ore without adding to its investment. This is practically impossible. Sustained growth almost invariably requires an investment in additional facilities -- either additional plant structures, machinery and equipment, or in the case of oil and gas companies, additional acreage for exploration.

What the investor likes to see is additional production or more efficient production as a result of capital expenditures. Failure to spend to obtain the most efficient equipment in our highly competitive economy can lead to higher costs and thus to the loss of business.

Your Company's balance sheet does not contain one class of assets, i.e., those known as intangibles because they represent nonphysical items. Intangibles include good will, trademarks, patents and copyrights, among others. Years ago, it was more common than at present to show items of an intangible nature. In computing the company's net worth or the book value of the stock, the value at which any intangible item is carried in the balance sheet is omitted. It is the tangible net worth or tangible book value that is used for purposes of financial analysis.

basis, which generally is cost or current market price, whichever is lower. This method avoids overstating earnings and assets as a result of sharp increases in prices on the commodity markets.

A steady drop in the relation of sales to inventories, the so-called "inventory turnover" may be a warning: (a) that inventories are too heavy for the best results, adding to the dangers from falling prices; (b) in the case of merchandising companies sales policy is not aggressive enough; (c) buying is not skillful and a large part of the goods on the shelves may depreciate in value because of shifts in public taste or style.

There are a number of methods of valuing inventories. The most widely used is the first-in-first-out method, in which it is assumed that the oldest items are used or sold before later purchases or productions. Unavoidably, this method leads to the inclusion in income of unrealized appreciation in the value of inventories when commodity prices are rising. This increase is sometimes known as inventory profits or "fool's profits" because if rising prices are followed by a fall the price appreciation may never be realized.

To cushion the impact of rapid price changes, the last-in first-out method (LIFO) of inventory valuation has been adopted by many companies. LIFO is intended principally to match current costs against current revenues. Sales are costed on the basis of inventory acquired most recently, or last-in, while first-in inventory is regarded as unsold. Consequently, in a period of rising prices, LIFO results in the application of a higher unit cost to items sold and a lower unit cost to inventory still unsold. The converse is true in a period of falling prices.

The rate of inventory turnover varies considerably among different industries. It is much higher in foods and automobiles, for example, than in tobacco or farm machinery.

Your Company's current assets increased during the year by \$4.2 million mainly because of a \$2.4 million increase in inventories and a \$1.0 million rise in receivables. Normally these increases would result from a larger dollar sales volume due to the sale of a larger number of units, to higher prices, or to a combination of both.

Studies of industrial companies that failed show that the proportion of total current assets to fixed assets usually declined persistently. In other words, it may not be wise to expand plant facilities at the sacrifice of current assets.

FIXED ASSETS, BUILDINGS, MACHINERY AND EQUIPMENT (less accumulated depreciation) — LAND

Your Company has plants in Connecticut, Ohio and North Carolina, but they are lumped together in the balance sheet. This item includes the structures, machinery and equipment, and such assets as tools and motor vehicles.

Except for land, fixed assets have a limited useful life. Each year a provision is

Liabilities & Stockholders' Equity

CURRENT LIABILITIES

Your Company's debt is divided into two classes: "current" or money due and payable within a year, and "long-term" debt that need not be paid until after one year.

Your Company's current liabilities as a rule are made up of several classes.

Accounts payable, i.e., money owed to suppliers of raw materials, and other costs that have to be met in the usual course of business. Ordinarily, when sales are expanding, there will be some increase in this item.

Accrued liabilities, which may represent such items as unpaid wages, salaries and commissions. This item is also likely to vary with the volume of business and many other factors.

Current maturity of long-term debt merely indicates the amount of such debt due in the next year. Often, a term loan due over a period of many years may provide for serial payments.

Federal income and other taxes includes all accrued taxes. Sometimes the amount due for federal income taxes is shown separately. Through payment of local taxes of various kinds, which are not generally set forth in detail in financial statements, corporations make important contributions to the welfare of local communities.

Dividends payable represents preferred or common dividends, or both, declared by the board of directors, but not yet paid. Once a dividend has been declared it becomes an obligation.

Your Company owed \$3 million more at the end of 1971 than at the end of the preceding year. Management has to plan carefully to meet current liabilities or obligations. Sometimes rapid growth makes planning all the more difficult. In recent years, a business in a sound financial position has had little or no difficulty in obtaining necessary bank credit.

Important working-capital relationships are discussed under "7 Keys to Value."

RESERVES

These reserves, if any, are not to be confused with the accumulated depreciation and depletion, which in the case of Your Company has appeared as a deduction from fixed assets. These reserves earmark appropriations from surplus not to be used for dividend payments. Such reserves may be set up against possible losses

from declines in inventory value, or for various other contingencies. Ultimately, contingent reserves may be restored to surplus and become available for dividends.

Reserve funds are sometimes confused with reserves. Reserve funds are assets. For example, a company may set aside a sum in cash for a special construction program.

CAPITAL STRUCTURE: DEBT AND STOCKHOLDERS' EQUITY

Capital includes all sums used in the business, i.e., the funds invested by lenders and stockholders as well as the funds representing reinvested earnings. In the financial world, the term "capital structure" is used frequently and simply means the total of all long-term debt, preferred stock, common stock and surplus.

The company may have raised funds through the sale of long-term debt (mortgage bonds or debentures), preferred stock and common stock; or it may have outstanding only bonds and common stock, or preferred stock and common stock, or common stock only. In the last case it is said the capital structure is "simple" or that the company has a "one-stock capitalization."

The point to note is that whatever the combination may be, a company *must* have common stock — it *may* have other securities. This results from the nature of common stock, which represents ownership. The common stockholder takes the greatest risk and stands to gain most from a company's prosperity. A holder of a bond or debenture is a creditor. Preferred stockholders have certain priorities over the common shareholders. The investor will learn, however, that legal relationships do not determine values. Bonds and preferred stocks of one company may be inferior in quality to common stocks of other companies.

LONG-TERM DEBT

The amount included in this caption is the face or principal sum due at maturity, less any amount that is payable in less than a year. Sums repaid in the past, of course, have already been eliminated. In the case of Your Company, the original issue of debentures was \$35 million which had been reduced to \$20 million in 1970. A new period of expansion during 1971 involved the issuance of an additional \$7 million worth of debentures. Debt may consist of several different issues, representing money borrowed at various times and at different rates of interest.

Usually, long term debt may be called or redeemed by the company prior to maturity at a premium of three to five per cent over the principal amount.

STOCKHOLDERS' EQUITY

Preferred Stock. At one time Your Company raised funds through the sale of preferred stock. The rights of the preferred stockholder, like those of a holder of debt securities, are determined by contract. Usually a preferred stockholder is entitled to a fixed dividend before common stockholders may receive dividends,

and to priority in the event of dissolution or liquidation. During the past fifty years dividends on preferred stocks usually have been "cumulative," i.e., no dividend can be declared on the common stock if there are any dividends in arrears on the preferred. Most preferred stocks now have voting power in the event that four quarterly dividend payments have not been declared.

Like bonds and debentures, preferred stocks usually are redeemable at the company's option at fixed prices.

Common Stocks may be shown on the books at "par value" or, if the stock has no par value, at a "stated value." The thing to remember is that the par value or the stated value of "no par common stock" is an arbitrary amount, having no relation to the market value of the common stock, or to what would be received in liquidation. Market value is determined by buyers and sellers who take into account earnings, dividends, prospects, the caliber of management and general business outlook.

Surplus. Capital surplus includes such items as contributed assets or the premium received from the sale of stock over the par value.

Earned surplus represents past retained earnings, i.e., earnings not paid in dividends.

In other words, surplus is the excess of the total stockholders' equity, or net worth, over the total par value, or stated value, of the capital stock outstanding. It is not a tangible sum or an amount on deposit in a bank. Past earnings may have been used in part for the purchase of new machinery. To avoid misunderstanding, more and more companies no longer use the term "surplus" in their financial reports but use "earnings retained and invested in the business" or some similar phrase. Theoretically, at least, the surplus is available for dividends, but the ability of a company to pay dividends depends as much on its financial position as on the amount of surplus in the balance sheet. Sometimes, the creditors place a restriction on the extent to which surplus is available for dividends. Such limitations are usually referred to in a footnote to the balance sheet.

There is no "ideal" capital structure. Even so, the investor should be on guard against too heavy an amount of long-term debt and preferred stock in relation to common stock and surplus. Your Company's capital structure at the end of 1970 was:

	Million	Percent of Total
Long-Term Debt	\$ 26.0	24.4%
Preferred Stock	6.0	5.7
Common Stock		
Capital Surplus	74.3	69.9
Earned Surplus		
TOTAL	\$106.3	100.0%

As an ordinary manufacturing enterprise, Your Company has a "sound" or well balanced capital structure. In other words, the relative amount of different securities gives the senior security holders protection without placing the common stock in a dangerous position.

A one-stock capitalization may be attractive because there are no prior claims ahead of the common stock. But there may be an advantage in using senior securities provided the funds borrowed can earn more than is needed to pay the interest on debt or dividends on the preferred stock. Long-term debt and preferred stock add what is called "leverage" to a company's capital structure. The degree of leverage is the percentage of the common stock and surplus to the total capitalization. After paying fixed charges and preferred dividends, increased earnings benefit the common stock. Therefore, leverage is an advantage to the common stockholders while earnings are increasing. But a high degree of leverage may be dangerous if a company's earnings are irregular or it is engaged in a cyclical industry. For industrial companies, a rough maximum for bonds and preferred stocks is that they should not exceed 50% of the total capitalization.

The smaller the year-to-year fluctuations in earnings, the larger the amount of senior securities outstanding may be without incurring danger. That is why electric and gas utility companies may properly have a 25-30% common-stock equity (ratio of common stock and surplus to total capitalization) whereas this would be considered undesirable for a meatpacking or steel company, or a railroad. A 50% common-stock equity is generally regarded as a minimum for a manufacturing or retail business.

Income Statement

There was a time when quite a few companies did not publish their sales figures, generally because of the mistaken notion that such data would help their competitors. But today no one would think of investing in a company without asking "How much business does the company do?" An income statement begins by providing this information. For public utility and railroad companies, "revenues" or "operating revenues" are the terms used.

In 1971 Your Company had an increase in sales of \$5.8 million. The investors like to see a year-to-year increase in sales. That usually means progress, if the increase also represents increased profits, although it is not always possible to expand sales regularly. In addition, a favorable showing depends on what other companies in the industry have done in the same period. If the whole industry has increased sales by 12% and a specific company only 6%, the company's results might be regarded as not very satisfactory.

It is always well to determine whether unit sales have expanded or if the larger dollar volume is derived entirely from price increases. More companies now publish unit sales as supplementary information.

Cost of goods sold

The expenses of doing business involve outlays for raw materials, wages salaries, supplies, power and light, and other costs.

Your Company was able to keep its expenses down relatively well so that the gain in sales was not entirely eaten up by rising costs. Some companies segregate various parts of the total costs of goods sold. For management purposes costs are broken down further into fixed costs, or those which do not change with volume, and variable costs, or those which are flexible.

The lower the cost of goods sold, or the operating cost as it is also called, the larger is the gross profit margin. The investor likes to see a declining operating ratio (percentage of cost of goods sold to sales).

Selling, general and administrative expenses

Costs more directly involved in production, such as wages and raw-material purchases are differentiated from selling, general and administrative expenses. Your Company spent a somewhat larger part of last year's receipts for the latter group.

This group of expenses varies considerably with the kind of business. For example, companies selling to consumers usually spend larger sums for advertising than companies selling to other manufacturers or companies that obtain a large part of their orders from government.

Depreciation and depletion

These expenses as well as amortization of various types differ in a very important respect from the other expenses already considered. While looked upon properly as a cost item, the provision for depreciation does not represent — like other costs — an actual cash outlay. Every piece of machinery and equipment has a limited period of usefulness even when kept in good repair. Thus, Your Company may have a provision for "using up" the service life of each asset, depending on its characteristics. The U. S. Treasury Department holds that depreciation for tax purposes can be related only to cost. It sets forth maximum depreciation allowances

in computing a company's taxable income. If a company did not provide for the wear and tear on its production facilities, its profits and net worth would be overstated.

Depletion is somewhat similar to depreciation. It is not a cash outgo and provides for the reduction in the value of natural resources as they are used. Timber, coal, copper, oil and gas are examples of the types of assets that are subject to depletion.

The higher the amounts provided for depreciation and depletion, the lower is the net reported income. Conversely, large deductions make for a high "cash flow," which is the total of net income plus the deduction for depreciation and depletion. "Cash flow" is sometimes considered a better guide to future dividend policy than net income. However, working capital and projected capital expenditures should always be considered.

OPERATING PROFIT

This is sometimes referred to as the pre-tax profit. As a percentage of sales, it indicates the pre-tax profit margin. In 1971 and 1970 the pre-tax profit margins were 19.5% and 18.5%, respectively. For a check on management efficiency, some analysts exclude depreciation and depletion in calculating pre-tax profit margin.

Manufacturing companies in 1971 had pre-tax profit margins (after depreciation and depletion) of around 8%. Incidentally, small companies do not necessarily have the smallest pre-tax profit margins, nor the big companies the widest.

INTEREST CHARGES

This is the amount required to meet interest payments on debt. Interest being deductible as an expense before taxes, it is often less costly to borrow money than to have funds supplied by stockholders.

The bondholder likes to see at least three dollars of available earnings for each dollar's interest the company must pay. That would mean interest charges were "covered" three times. Your Company's debenture holders can sleep well, for interest charges in 1971 were covered over 17 times before provision for federal income taxes.

EARNINGS BEFORE INCOME TAXES

In the case of Your Company, this is simply the operating profit minus interest charges.

PROVISION FOR FEDERAL AND STATE TAXES ON INCOME

The federal tax collector, at the present corporate-profits tax rate, has more than a half interest in the earnings of Your Company (and others too). Some readers may remember when a 12½% rate seemed too high to bear.

NET INCOME FOR THE YEAR

This item, also known as earnings or profits is, after all, the acid test of business management. Earnings over the years sum up all the effort, achievement, progress, mistakes and problems of the business. Your Company's net income in 1971 after all expenses and deductions, including taxes, was about 4.2 per cent higher than for the previous year. So far, so good. Since dividends are paid out of profits a healthy state of affairs requires "good" earnings. But that doesn't necessarily mean earnings must increase each year. Some years will be better than others, although there are reasons to believe that the extremes of boom and bust on the scale of 1929 and 1932 can be avoided.

There are two standard tests of how good earnings are. The first is the relation of net income to sales. Your Company in 1971 earned 8.5 per cent on each dollar's sales against 8.6 per cent in 1970. It will be noted that net income may increase largely because sales have risen, or, on the other hand, mainly because expenses have been reduced in relation to sales.

Average net income to sales varies considerably among different industries and the investor must consider other factors in judging results. For example, chain-store grocery companies earn less than 2 cents on each sales dollar, whereas the recent average in manufacturing is about 6 cents. This does not mean, however, that food distribution is necessarily a poor industry for investment.

The second test concerns net earnings in relation to the amount of the stockholders' investment. Grocery chains earn about 10 per cent on the funds the shareholders have in the business. In 1971 Your Company's earnings on the stockholders' investment (net worth) amounted to 12.3 per cent.

DIVIDENDS ON PREFERRED STOCK

The investment quality of a preferred stock is determined largely by the size of net income in relation to annual dividend requirements. Your Company's 1969 net income, in financial language, "covered" the preferred dividends 33 times. That means earnings could shrink drastically without creating any danger signs regarding payment of preferred dividends.

Careful investors also take note of the amount of interest required on a company's indebtedness, for interest comes ahead of the preferred stockholders' dividends. The dividends requirement on the preferred stock is not an obligation in the same way as the interest due a creditor. In a sense, a preferred stock is a "limited partner."

On cumulative preferred stocks, dividends that have not been paid in the past,

in addition to current dividends, must be cleared up before dividends may be paid on the common stock.

BALANCE OF NET INCOME AVAILABLE FOR COMMON STOCK

After deducting preferred-stock dividends, the remainder represents the balance available for common stocks.

This is the most commonly used item to indicate earnings for the common stockholder when reduced to a per-share basis. Your Company earned \$5.24 per share on the common stock in 1971 compared with \$5.03 per share in 1970. Of course, if a company does not have preferred stock, the common stockholders' per-share results are found by merely dividing the net income by the number of outstanding shares, or the average number of shares outstanding if there has been a substantial change during the year.

Earned Surplus

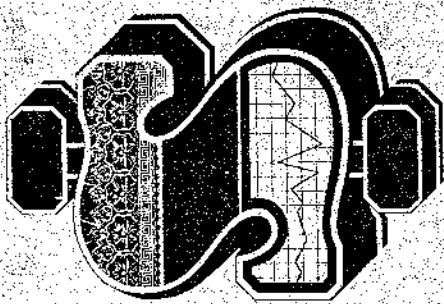
This is also known as income retained in the business. The amount retained from year to year depends on both net income and dividend payments.

Reinvested earnings, it is emphasized, are not as a rule retained in the form of cash. Normally, such reinvested earnings become part of the company's other assets — such as inventories and receivables — or are used for capital outlays to add to plant and equipment. Or they may be used to repay indebtedness. Over a period of time reinvested earnings should add to a company's earning ability.

ACCOUNTING PRINCIPLES

The accountant's report that accompanies a financial statement expresses an opinion, not a guarantee, because the values of many items in financial statements are not subject to precise measurement. Nevertheless, the opinion of an independent expert, with experience and skill in auditing and accounting, serves three important purposes: It usually states that: (1) the statements presented have been prepared in accordance with generally accepted principles of accounting; (2) the financial statements present fairly the financial condition at the end of the year and the results of operations during the period covered; (3) the accounting principles followed are consistent with those of the preceding year.

"Your Company"



Over the years, security analysts, brokers and investors have found that more can be gotten out of financial statements by applying ratios that focus attention on significant relationships in the income account and balance sheet. Those used here are not the only ratios that have been developed, of course, and they are applicable mainly to industrial companies. But even so, the ratios chosen are basic. The investor should regard his ownership as a proprietary interest. The facts he ought to know are the same as if he were to put his money into running his own business.

Once the "Keys to Value" are understood, it is fairly simple to apply them to Your Company's financial statements. The text of annual reports will often clarify the reasons for trends in the ratios. Naturally, interpretation of financial statements cannot provide a magic formula in the appraisal of securities. The economist, accountant, business executive and financial analyst, in fact, will often differ in their interpretation as to how far financial statements help in determining value.

The approach used here is only one of several and necessarily omits broad economic factors, market analysis, psychology and such a vital element as technology in the struggle for industrial survival. The importance of management cannot be overestimated, but this discussion is confined to understanding financial statements, a step in the final judgment of management.

1. Pre-tax Profit Margin

This is the ratio of profit, before interest and taxes, to sales. It is expressed as a percentage of sales and is found by dividing the operating profit by sales. Some analysts compute the pre-tax profit margin without including depreciation and depletion as part of cost—because the provision has nothing to do with the efficiency of operations. For 1971 Your Company's pre-tax profit margin was 19.5%. In 1970 pre-tax profit margin was 18.5%. It is usually assumed that a material increase in sales will help widen the profit margin. Certain costs are fixed, i.e., they do not rise or fall in the same proportion as changes in volume. Such costs are interest, rent and real property taxes. Ordinarily, because of these fixed costs, profits tend to increase and decline more rapidly percentage-wise than sales.

2. Current (Operating) Ratio

Probably the most generally used for industrial companies, this is the ratio of current assets to current liabilities. A 2-for-1 ratio is the standard. Your Company's current ratio at the end of 1971 was approximately 2.24 compared to 2.38 in 1970. The change was minor.

	1971	1970
1 Pre-tax Profit Margin	19.5%	18.5%
2 Current Ratio	2.24	2.38
3 Liquidity Ratio	41.7%	44.1%
4 Capitalization Ratios:		
Long-Term Debt	24.4%	20.8%
Preferred Stock	5.7	6.3
Common Stock and Surplus	709.9	72.9
5 Sales to Fixed Assets	100.0%	100.0%
6 Sales-to-tax-efforts	1.1	1.2
7 Net Income to Net Worth	4.3	4.5
	12.3%	12.5%

A gradual increase in the current ratio usually is a healthy sign of improved financial strength. Ordinarily, a ratio of more than 4 or 5 to 1 is regarded as unnecessary, and may in fact be the result of an insufficient volume of business to produce a desirable level of earnings. To illustrate, in the thirties when railroad equipment orders were extremely small, some railroad equipment companies reported a high current ratio. Earnings, on the other hand, were unsatisfactory. The point again is that the investor should not keep his attention focused solely on the balance sheet or income account. Both are significant in financial analysis.

In 1971 Your Company did not improve its position in this regard because it used substantial funds to increase its plant and equipment. The ratio could have been better if Your Company had spent less for additions to its productive facilities, or had raised more funds for this purpose through the sale of securities, or paid less in dividends. But for one reason or another, none of these alternatives was deemed either necessary or desirable. This particular case illustrates why entire annual report must be examined and the whole financial statement should be examined.

2. Liquidity Ratios

This is the ratio of cash and equivalent (marketable securities) to total current liabilities. It is also expressed as a percentage figure and results from dividing cash and equivalent by total current liabilities.

This ratio is important as a supplement to the current ratio because the immediate ability of a company to meet current obligations or pay larger dividends may be impaired despite a higher current ratio. At the close of 1971, Your Company's liquidity ratio was 41.7% compared with 44.1% in 1970. A decline in the liquidity ratio often takes place during a period of expansion and rising prices because of heavier capital expenditures and larger accounts payable. If the decline persists, it may mean that the company will have to raise additional capital, but unless the decline in the liquidity ratio is drastic, this is something to be watched rather than necessarily a cause for concern.

3. Capitalization Ratios

These are the percentages of each type of investment in the company to the total investment. As shown previously, the capitalization is made up of Long-Term Debt, Preferred Stock, Common Stock and Surplus.

In financial circles, the word "capitalization" sometimes is loosely used to cover only the outstanding securities, but the surplus or retained earnings is an important part of the ownership interest.

The form of the capitalization results from the nature of the industry, the company's financial position, and in part from policy. Usually, the higher the ratio

of common stock and surplus the more assured is the position of the common stock, as it has less "ahead" of it in the way of debt securities or preferred stock with prior claims. Companies in stable industries, such as electric light and power, may with safety have a higher proportion of debt financing than most industrial companies.

Your Company, at the end of 1971, has a common stock equity or ratio of approximately 70%. This is the total of common stock, capital surplus and earned surplus divided by the total of these items plus the outstanding debentures and preferred stock. The common-stock ratio was somewhat smaller than in the previous year, because of the issuance of additional debentures during the year. Since the surplus was also larger, due to reinvested earnings, the change was slight and the common-stock equity remained high.

4. Fixed Assets Ratio

This ratio is computed by dividing the annual sales by the value before depreciation and amortization of plant, equipment and land at the end of the year. The ratio is important because it helps point up whether or not the funds used to enlarge productive facilities are being spent wisely.

In most cases, of course, a sizable expansion in facilities should lead to larger sales volume. If it doesn't, the added money tied up in the plant, equipment, and land is not producing properly or is not being utilized fully. Or, it may be that sales policies should be altered. After a big increase in capacity, it often takes time for demand to grow up to capacity, and in the meantime, the ratio of sales to fixed assets will naturally suffer.

In 1971 Your Company's ratio of sales to fixed assets amounted to approximately 1.1 to 1 compared with 1.2 to 1 in the previous year. But we learn from the annual report that there were delays in getting production under way at the new plant, which isn't uncommon.

In Your Company's balance sheet the fixed assets are shown both as a gross figure, and as a net figure, i.e., before and after accumulated depreciation. Sometimes, the details appear in a footnote to the balance sheet which sets forth the cost of the buildings, machinery, equipment and land. For our computation we have used the gross figure for all fixed assets, \$105.2 million in 1971 and \$93.4 million in 1970. The ratio is low, indicating that Your Company probably is in a "heavy" type of industry -- possibly steel or paper rather than textiles or drugs, which ordinarily have a larger sales volume in relation to plant investment.

5. Sales to Inventory Ratio

This ratio is computed by dividing the year's sales by the year-end inventories. The so-called "inventory turnover" is important as a guide to whether or not the

enterprise is investing too heavily in inventories. In this event a setback in sales or a drop in commodity prices would be particularly unfavorable. A more accurate comparison would result from the use of an average of inventories at the beginning and at the end of the year.

Because inventories are a larger part of the assets of a merchandising enterprise than of most manufacturing companies, this ratio is especially worthy of note in the analysis of a retail business. A high ratio denotes a good quality of merchandise and correct pricing policies. A definite downtrend may be a warning signal of poor merchandising policy, poor location, or "stale" merchandise on the shelves. The nature of the industry has an important part in determining whether a ratio is "high" or "low."

Your Company's sales-to-inventories ratio in 1971 was approximately 4.3 to 1 compared with 4.5 to 1 in 1970. This decline could have resulted from purchases of raw materials in anticipation of an increase in prices or a falling off in demand toward the end of the year.

7. Net Income to Net Worth

This is another ratio given as a percentage and is derived from dividing net income by the total of the preferred stock, common stock and surplus accounts. This is one of the most significant of all the financial ratios. It supplies the answer to the vital question: "How much is the company earning on the stockholders' investment?" Naturally, a large or increasing ratio is favorable. In a competitive society, of course, an extraordinarily high ratio may invite more intense competition. An increase due to "inventory profits" may be shortlived because of rapid changes of commodity prices.

Broad economic forces may change the general direction of net income to net worth. A higher rate may be due to general prosperity and a decline to a recession or less favorable conditions, or to higher taxes.

Your Company's net income was equivalent to 12.3% on net worth in 1971 compared with 12.5% in 1970. The change didn't amount to much. According to general surveys of all manufacturing corporations in the United States a return of over 10 per cent appears to be better than average. Executives often hesitate to embark on outlays for new plant and equipment unless they feel that an annual return of at least 10% on the new investment may be expected.

It will be observed that Your Company's ratio of return on net worth last year exceeded that of net income to each dollar's sales, which was about 8.6%. While the latter ratio is of interest, it is not as significant as the return on the stockholder's investment, as already pointed out.

INVESTMENT ANALYSIS

For investment purposes, a number of ratios in addition to the "7 Keys" have been developed to aid in appraising securities.

In the following paragraphs these tests have been applied to the securities of Your Company. A brief description of the terms and their significance has been supplied so that the investor will find it easier to apply these tests to other securities.

1. Interest coverage
2. Earnings per share — preferred stock
3. Combined or over-all coverage
4. Earnings per share — common stock
5. Dividends per share — common stock
6. Dividend payout
7. Book value per share — common stock
8. Price-earnings multiple
9. Dividend return

1. INTEREST COVERAGE — the number of times interest charges or requirements have been earned. This ratio is determined by dividing the earnings (or balance) available for such payments — before income taxes — by the annual interest charges. The practice of showing the interest coverage after income taxes is sometimes followed. Actually interest is a claim *prior* to income taxes. Therefore it is better practice to compute interest coverage before provision for income taxes.

Your Company's interest (or fixed charges) were covered 17.3 times in 1971 and 20 times in 1970, a very high coverage. In this case, the earnings could decline to only 6% of the 1971 results and interest still would be earned. Ordinarily, a manufacturing company's interest coverage is regarded as satisfactory at 5 times; among public utilities a 3-times average coverage is satisfactory.

2. EARNINGS PER SHARE — PREFERRED STOCK. This ratio is found by merely dividing the net income by the number of shares of preferred stock. As Your Company had outstanding 60,000 shares of preferred stock and net income in 1971 amounted to \$9.9 million after interest and taxes, the earnings were \$165 per share. It could also be said that dividends were earned 33 times. In 1970 earnings per share of preferred stock were approximately \$158 and consequently preferred dividends were earned 31 times. In both cases earnings were far above "standard" requirements.

3. COMBINED OR OVER-ALL COVERAGE. A preferred stock of an industrial company with average earnings (before interest on bonds but after taxes) for

five years of not less than 4 times the combined interest and preferred dividend requirements is usually regarded as satisfactory. For a public utility preferred, earnings of around 3 times the combined requirements make the stock high grade. As a rule of thumb a preferred stock is considered well protected if dividend payments on the common stock, over a five-year period, average upwards of 3 to 4 times the preferred dividend requirements.

In 1971 Your Company's combined coverage of interest and preferred dividends after taxes was approximately 7 times. To determine this, you divide the adjusted operating profit (profit before interest but after taxes) of \$11.2 million, by the total of interest and preferred dividends, which was \$1.6 million. This is a more conservative method than merely considering the net income available for the preferred stock.

6. EARNINGS PER SHARE — COMMON STOCK. This is an easy one with complications. The balance after preferred dividends is divided by the number of shares of common stock outstanding. In 1971, this balance was \$9.6 million and there were outstanding 1,830,000 shares. Accordingly, earnings per share were \$5.24 in 1969 and \$5.03 in 1970.

If the company sold additional shares during the year it would be customary to show earnings on the average number of shares outstanding during the year, in addition perhaps to the earnings on the outstanding shares at the end of the year. (The company may have had the benefit of the additional funds for only a few months.)

5. DIVIDENDS PER SHARE — COMMON STOCK. This, too, is a simple computation, and is found by dividing the dividends paid on the common stock by the number of shares. In 1971, Your Company paid \$5,490,000 on 1,830,000 common shares—or \$3.00 per share. In 1970, it paid \$4,575,000—or \$2.50 per share.

Dividend policy is a matter for the board of directors. The common shareholder, unlike the bond holder, has no promise from the company that he will be paid a fixed return. The dividends paid to the common stockholder depend on earnings, the availability of funds and the dividend policy.

7. DIVIDEND PAYOUT. This term refers to the percentage of earnings on the common stock actually paid in dividends. Your Company's dividend payout was approximately 57% in 1971 (\$3.00 divided by \$5.24) and almost 50% in 1970.

In practice, the dividend payout will vary, according to many fluctuating factors. Among these are the stability of earnings, the need for new capital, the directors' judgment as to the outlook for earnings and the general views of the management. Some companies habitually plow back a large part of earnings; part because of a desire to reduce the amount of funds to be raised from outside sources.

In recent years common-stock dividends of industrial companies have averaged

about 55% of earnings. In previous decades the payout was somewhat larger. But electric and gas utility companies have paid an average of over 70% of their earnings in recent years because of the greater stability of their income. On the other hand, growth companies in the chemical and oil industries have paid substantially less than the average for industrial companies.

7. BOOK VALUE PER SHARE — COMMON STOCK. Book value is found by adding the stated or par value of the common stock to the surplus accounts and dividing the total by the number of shares. Accordingly, Your Company's common stock had a book value at the end of 1971 of \$40.60 per share.

Common stock	\$18.3 million
Capital surplus	9.6
Earned surplus	46.4
	\$74.3 million
Book value for each of the 1,830,000 shares	\$40.60 (Dec. 31, 1971)
(as of December 31, 1970 the figure was \$38.31 per share.)	

Another method of calculating book value — called the long way — is to deduct from total assets (exclusive of such intangible items as good will and patents) all liabilities and preferred stock, if any. The remainder is divided by the number of common shares and the result is the book value per share, or net tangible assets per share of common stock.

For industrial companies, book value per share isn't nearly as important as earnings and prospects. Usually, the largest class of assets is plant and equipment, and the cost is very different from present sales value. According to an old axiom, assets are worth only what they can earn.

But the book value of the common stock of money corporations such as banks, insurance companies and investment companies is more significant. The assets of these companies are in securities or other forms that can readily be turned into cash. The book value of public-utility common stocks is also important, since these regulated companies are entitled by law to earn a fair return on their investment, which is made up largely of fixed assets. Their rates, and hence, earnings are based on the value of their investment in plant and equipment. Although book value in a single year is almost meaningless in appraising an industrial common stock, the course of book value per share over a period of years may be very significant.

The constant reinvestment of earnings often adds to productive facilities and total strength. In other words, the fact that book value per share at the end of last year was \$40 per share doesn't tell us much. However, if the figure was \$28 per share four years ago, \$12 a share has been added in this period. Ordinarily, this addition should result in an increase in earning power.

PRICE-EARNINGS MULTIPLE. A shorthand way of saying that a stock is selling in the market at X times earnings. If the common stock of Your Company is selling at \$60 per share, it would be selling at approximately 11.4 times earnings (\$60 ÷ \$5.24).

What is a proper price-earnings multiple? This is really an agonizing question. No one knows exactly what it should be. We do know the average price-earnings multiple has varied widely from time to time. As a matter of interest, here is the average for a number of years of the stocks in the Standard & Poor's index.

ANNUAL	Industrials		Rails		Utilities	
	High	Low	High	Low	High	Low
1932.....	23.78	11.55	17.53	5.91	18.20	6.49
1933.....	27.23	11.28	8.55	22.43	12.56	
1934.....	23.60	17.08	18.47	11.60	19.34	10.09
1935.....	19.69	11.98	13.86	8.58	17.03	7.93
1936.....	18.50	13.78	13.14	9.03	17.86	
1937.....	16.69	8.97	18.00	7.95	17.57	
1938.....	24.39	14.93	12.80	11.23	14.08	
1939.....	16.19	12.27	9.63	6.23	13.38	10.71
1940.....	12.24	8.58	7.58	5.10	13.55	9.89
1941.....	9.57	7.64	4.49	3.41	13.12	7.56
1942.....	12.58	9.25	2.53	1.95	9.13	6.65
1943.....	15.62	12.40	4.08	2.89	11.92	8.26
1944.....	16.23	14.07	6.23	4.56	12.84	11.22
1945.....	20.07	15.26	6.65	5.26	18.27	12.07
1946.....	17.45	12.86	12.00	7.32	13.03	9.36
1947.....	9.32	7.89	7.41	5.38	12.65	9.66
1948.....	7.22	5.79	5.64	4.37	11.27	9.73
1949.....	6.88	5.51	6.18	4.80	11.95	9.54
1950.....	7.04	5.58	5.27	3.62	12.50	10.69
1951.....	9.58	8.21	7.50	6.11	14.12	12.74
1952.....	10.92	8.46	7.25	5.75	14.89	13.27
1953.....	10.37	8.72	6.70	5.28	14.19	12.41
1954.....	12.90	8.50	10.38	6.87	15.70	13.24
1955.....	13.12	9.43	8.77	7.00	15.73	14.13
1956.....	15.09	12.95	9.39	7.61	15.28	14.03
1957.....	15.21	11.99	9.75	6.26	15.24	12.87
1958.....	19.96	14.64	11.90	7.46	18.26	13.64
1959.....	18.50	16.17	12.50	10.52	19.10	17.60
1960.....	19.17	16.32	14.25	11.09	19.24	16.26
1961.....	22.76	18.06	16.42	13.79	24.36	18.43
1962.....	19.44	14.16	11.89	9.24	21.28	16.41
1963.....	18.69	13.44	12.80	10.34	21.11	19.03
1964.....	18.69	16.51	14.01	11.39	21.42	19.37
1965.....	17.89	15.69	12.95	10.32	20.15	18.56
1966.....	17.08	13.22	12.83	8.64	18.12	14.19
1967.....	18.75	15.07	14.74	11.85	16.50	14.14
1968.....	19.19	15.46	14.72	10.71	16.39	13.85
1970.....	19.19	14.10	13.16	8.33	13.27	10.25
1971-1.....	20.66	18.40	13.11	11.37	13.75	12.94
2.....	20.99	19.53	13.68	12.48	13.27	12.12
3.....	19.96	18.36	15.79	12.56	12.64	11.49
4.....	20.31	17.71	14.77	12.11	12.41	11.30

†Based on extremes of closing prices during period. The quarterly price-earnings are based on the total of earnings during the 12 months preceding the end of each quarter, applied to the high and low prices for the quarter.

QUARTERLY

P—Preliminary.

The price-earnings multiple varies not only with economic conditions but expectations of the future, or the confidence of buyers that they will be able to sell their stock to other buyers at higher prices. Interest rates and the level of bond prices are other important factors.

For obvious reasons investors are willing to pay a higher price for the stocks of companies whose earnings may grow than for stocks of companies in static industries. Of course, factors applying to individual companies must be considered in each case: management, financial position, capitalization, dividend policy and the market's appraisal of the stock of other similar companies.

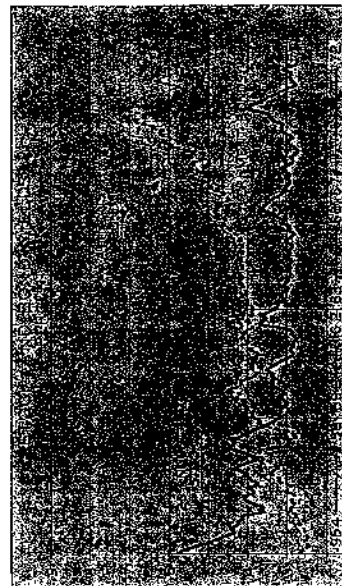
A rule of thumb used to be that a price of 10 times earnings amounted to a reasonable ratio. Many authorities believed a company that earned \$1 per share could pay 60 cents a share in dividends. Therefore, if the stock were to sell at \$10 per share, the price-earnings multiple would be 10-to-1 and the yield 6%. A price-earnings ratio of 12.5 to 14 would not seem unreasonable under certain conditions. At the latter price-earnings ratio, a stock earning \$1 per share would sell at \$14 and on a 60 cent dividend, would return 4.3%. Before income taxes were so high and inflationary tendencies had influenced investment policies, individual investors paid more attention to the relation between the return on bonds, preferred stocks and common stocks.

Actually, a stock isn't necessarily "high" if it sells above 12.5 to 14 times earnings, or "low" if it sells at a lower multiple. The more important considerations are projected earnings and dividend prospects.

DIVIDEND RETURN (Dividend yield or income). This is determined by dividing the annual dividend per share by the price of the stock. The indicated return on the common stock of Your Company (\$3 dividend divided by an assumed price of \$75) would be 4%.

Returns are generally lower on chemical and oil stocks, for example, than on shoe or textile stocks. Returns on industrial stocks are usually higher than on bank or public utility stocks, lower than on railroad stocks. This is, of course, a generality reflecting opinions as to growth of earnings, stability of dividends and similar factors. There are wide differences even among stocks of companies in the same industry due to investors' preferences.

Average yields of corporate bonds, government bonds and common stocks over the years are shown below:



Standard & Poor's
February 1, 1972

IMPORTANCE OF FINANCIAL RATIOS

The importance of financial ratios is evidenced by the growing number of companies that now include such computations as part of their annual reports.

In addition, a quarterly report published jointly by the Federal Trade Commission and Securities and Exchange Commission contains comprehensive data on the earnings and financial position of all manufacturing companies in the United States.

The reports for all quarters of 1950 and the first three quarters of 1951 include the following:

	1950	2-3 Q	3-4 Q	4-1 Q	1-2 Q	3-4 Q
	1950	1950	1950	1950	1950	1950
Annual rate of profit on stockholders' equity at end of period --						
Before federal income taxes (%)	16.0	17.1	15.1	13.3	15.1	13.2
After taxes (%)	9.2	10.1	9.0	8.7	8.9	10.7
Ratio of current assets to current liabilities	1.99	1.93	1.93	1.93	1.90	2.02
Ratio of total cash and U. S. Government securities to total current liabilities	.21	.20	.19	.20	.20	.22
Ratio of total stockholders' equity to debt	2.15	2.30	2.27	2.25	2.25	2.25

The foregoing figures -- being averages for all corporations -- are of significance only in recognizing the value of financial ratios. The figures themselves of course vary from industry to industry. The ratios also apply mainly to manufacturing companies.

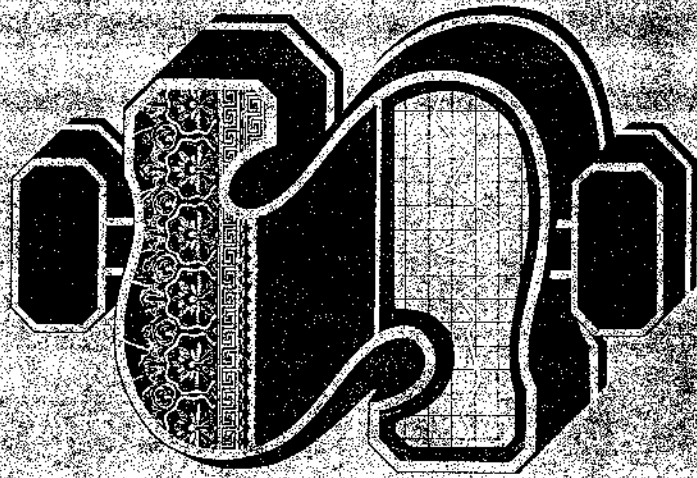
In the case of public-utility companies, for example, the current ratio is of little importance. On the other hand, the ratio of long-term debt to the property account is of prime importance. In railroad finance, the maintenance ratio is very important because such expenditures are heavier than for industrial or public-utility companies. Under-maintenance or over-maintenance affects reported earnings substantially.

CHANGE IS BASIC IN A GROWING ECONOMY

Over a long period of years, price-earnings multiples and yield relationships have been subject to broad changes. Change is inherent in a dynamic economy such as ours, and change generally entails risk. The degree of risk in the purchase of common stock varies, depending on many factors -- the type of industry in which the company is engaged, its financial position, earnings, dividends and prospects -- as well as on the level of stock prices.

But because common stock represents ownership, many shareholders in the long run may have an opportunity to benefit from research, reinvestment of earnings and the underlying growth of the economy.

Today the investor has available much more information than in the past about companies whose securities are listed on the New York Stock Exchange, Inc.



For RELEASE Monday, December 9, 1968

SECURITIES AND EXCHANGE COMMISSION
Washington, D. C.

SECURITIES ACT OF 1933
Release No. 4936

GUIDES FOR PREPARATION AND FILING OF REGISTRATION STATEMENTS

On December 20, 1967 the Commission published in Securities Act Release No. 4890 certain proposed guides for the preparation and filing of registration statements under the Securities Act of 1933 and invited the views and comments of interested persons thereon. These proposed guides represent a revision and expansion of those previously published in Securities Act Release No. 4666. A considerable number of very helpful comments were received in response to the above invitation and all of such comments have been carefully considered in the preparation of the definitive version of the guides, the text of which is attached hereto.

Certain changes have been made in the guides as a result of the staff's review of the comments submitted and as a result of its further consideration of the various matters involved. The guides are subject to review and modification from time to time as circumstances may require and interested persons are invited to submit, at any time, suggestions for such modifications or for the publication of guides covering additional matters.

These guides are not rules of the Commission nor are they published as bearing the Commission's official approval. They represent policies and practices followed by the Commission's Division of Corporation Finance in the administration of the registration requirements of the Act, but do not purport to furnish complete criteria for the preparation of registration statements.

The staff of the Division of Corporate Regulation is in the process of preparing guides describing the practices and policies followed by that Division in the examination and processing of registration statements filed by registered investment companies.

TABLE OF CONTENTS

<u>No.</u>	<u>General Provisions</u>	<u>Page</u>
1	Prefiling conferences with registrants	4
2	Letter of comment	4
3	Applicability of amended rules and forms to previously filed statements	4
4	Registration of securities for delayed offering	5
5	Voluminous and verbose prospectuses	6
6	Introductory statements	6
7	Dating of prospectuses	7
8	Pictorial or Graphic Representations in Prospectuses	7
9	Promoters	7
10	Registration of options, warrants or rights and other securities issued or sold to underwriters	7
<u>Underwriting and Distribution</u>		
11	Finders	8
12	Over-the-counter trading in warrants or rights (obsolete).....	9
13	Market Quotations-- Absence of established market	9
14	Underwriters' compensation from conversion of funds into foreign currency	9
15	Expenses of issuance and distribution	10
16	Disclosure with respect to newly organized underwriting firms	10
17	Disclosure of underwriting discounts and commissions	10
18	Original issue discount on debt securities	11
19	Distribution of preliminary prospectus	11
20	Mailing of amended preliminary prospectus to regional offices	12
<u>Use of Proceeds</u>		
21	Use of proceeds	12
<u>Financial Data</u>		
22	Summary of earnings	12
23	Current financial statements and related data	12
24	Currencies in which amounts are to be stated by foreign issuers	14
25	Manner of showing distributions by real estate syndicates and real estate investment trusts	14
26	Statement of dividend policy	15
<u>Business and Property</u>		
27	Names of customers and competitors	15
28	Extractive reserves	15

<u>No.</u>		<u>Page</u>
29	Disclosure of material long-term leases	16
30	Disclosure of principal sources of electric revenues on Form S-9	16
31	Disclosure of recent developments --Backlog	16
<u>Securities to be Registered</u>		
32	Liability of shareholders to laborers, servants or employees under State law	16
33	Notice of redemption of convertible securities or callable warrants	16
<u>Management and Control</u>		
34	Executive committee	17
35	Identification of members of board of directors selected by the underwriters	17
36	Effect of issuance of options or warrants to certain persons	17
<u>Written Consents</u>		
37	Consents of accountants	18
38	Consents of attorneys	18
<u>Exhibits</u>		
39	Charter amendments authorizing new securities	19
40	Underwriting agreements	19
41	Specimen bond	19
<u>Supplemental Information</u>		
42	Reports or memoranda concerning the registrant	19
43	Representations from selling security holders	20
44	Securities Act exemption for shares subject to options	20
45	Information as to over-the-counter market for securities to be registered	20
<u>Miscellaneous Disclosures</u>		
46	Statement as to indemnification	21
47	Enforceability of civil liabilities under the Act against foreign persons	22
48	Annual reports to security holders	22
49	Revision of prospectuses where a company and its employee plan have different fiscal years	23
50	Disclosure of confidential material to other government agencies	23
51	Release of price data on subscription offerings by listed companies	23
52	Disclosure as to listing on an exchange	24
53	Secondary distributions "at the market"	24

NOTE AS TO APPLICABILITY OF RULE 408

Notwithstanding the provisions of these guides, attention is invited to Rule 408 which requires that there shall, in any case, be added to the information required such further material information, if any, as may be necessary to make the required statements, in the light of the circumstances under which they are made, not misleading.

GENERAL PROVISIONS

1. Pre-filing Conferences with Registrants.

The Commission has a long established policy of holding its staff available for conferences with prospective registrants or their representatives in advance of filing a registration statement. These conferences may be held for the purpose of discussing generally the problems confronting a registrant in effecting registration or to resolve specific problems of an unusual nature which are sometimes presented by involved or complicated financial transactions.

Occasionally a registrant will request a pre-filing review of a registration statement, but such a review has been refused since it would delay the examination of material which has already been filed and would favor certain issuers at the expense of others. Registrants or their representatives also occasionally request the staff to draft a paragraph or other statement which will comply with some requirement or request for disclosure. The staff cannot undertake to prepare material for filing but limits itself to stating the kind of disclosure required, leaving the actual drafting to the registrant and its representatives.

2. Letter of Comment.

Letters of comment are sent out in most cases as a means of informing registrants of the respects in which a registration statement is deemed not to meet the disclosure and other requirements of the Act and the forms and regulations thereunder. A letter of comment may not be sent out, however, where the circumstances are such that an investigatory or stop order proceeding is deemed more appropriate.

3. Applicability of Amended Rules and Forms to Previously Filed Statements.

Rule 401 provides that a registration statement shall be prepared in accordance with the form prescribed therefor as in effect on the date of filing. In view of the fact that the filing of an amendment to a registration statement establishes a new filing date for the statement, the question has been raised as to whether an amendment to the registration statement which is filed after the registration form or an applicable rule has been amended must comply with the amended requirements. The filing date referred

to in Rule 401 is the initial filing date and in the absence of specific provisions to the contrary subsequent amendments to the form or to a rule do not apply, except to the extent noted below, to the registration statement, even though the statement may be thereafter amended.

Rule 432 provides that the form and contents of any prospectus need conform only to the applicable "rules" in effect at the time the registration statement became effective notwithstanding subsequent amendments to such rules. Although reference is made to "rules" this is deemed to include the registration forms also so that any amendment to a rule or registration form after the effective date of the registration statement does not apply to Section 10(a)(3) prospectuses except to the extent provided in paragraph (b) of Rule 432. That paragraph provides that the contents of any prospectus used after the lifting of a stop order shall conform to the applicable rules in effect at the time the stop order ceases to be effective.

4. Registration of Securities for Delayed Offering.

The last sentence of Section 6(a) of the Act provides that a registration statement shall be deemed effective only as to the securities specified therein as proposed to be offered. In view of this provision, securities cannot be registered if there is no intention to offer them within the proximate future. There are, however, certain types of deferred or extended offerings for which registration is permitted or required. A brief description of these offerings follows. It should be noted that where securities are so registered, they may not be sold at a time when the prospectus has not been kept up to date in accordance with the requirements of Section 10(a) of the Act.

(a) Where a company is engaged in a continuing program of issuing securities in connection with the acquisition of other companies under such circumstances that a public offering is involved, a reasonable amount of securities may be registered for such purpose.

(b) Where the purchasers of presently convertible securities may be deemed underwriters of such securities or of the securities into which they are convertible, within the meaning of Rule 155, both classes of securities may be registered prior to the purchase of the convertible securities. The securities into which presently convertible securities are convertible must, of course, be registered at the time of registration of the convertible securities for public offering.

(c) Where, in connection with a merger, consolidation or sale of assets, securities are issued to persons who may be deemed underwriters within the meaning of Rule 133(b), such securities may be registered even though an immediate offering is not contemplated.

(d) Where securities are to be pledged by persons in control of the issuer, such securities may be registered for the purpose of sale in the event of a default in compliance with the terms of the pledge agreement.

(e) Transferable options, warrants or rights issued to underwriters in connection with a public offering of securities, the securities issuable upon the exercise of such options, warrants or rights, and any securities sold to underwriters in connection with a public offering must be registered even though the underwriters represent that such options, warrants, rights or other securities are taken for investment and not with a view to distribution. (See #10)

(f) Securities may be registered if a representation is made that they will be publicly offered within a reasonable period of time after the effective date of the registration statement or if, because of particular circumstances, effective control over the resale of the securities by other persons would be difficult to maintain.

(g) Securities to be offered pursuant to options, warrants or rights may be registered if the options, warrants or rights are presently exercisable, or will become exercisable in the near future, even though such exercise may extend over a considerable period of time.

Registration statements of the above character may involve questions arising under Rules 10b-2, 10b-6 and 10b-7 under the Securities Exchange Act of 1934. (See #53)

5. Voluminous and Verbose Prospectuses.

Prospectuses are sometimes difficult to read and to understand. Registrants have been encouraged to reduce the size of the prospectus by careful organization of the material, appropriate arrangement and subordination of information, use of tables and the avoidance of prolix or technical expression and unnecessary detail. In this connection, attention is directed to Rule 460(f).

Material on the cover page of the prospectus should be as brief as possible with an appropriate cross reference to more complete information elsewhere in the prospectus, particularly where the underwriters receive multiple benefits that cannot be completely described on the cover page. (See #17)

6. Introductory Statements.

Where appropriate to a clear understanding by investors there should be set forth immediately following the cover page of the prospectus under an appropriate caption a carefully organized series of short, concise paragraphs, under subcaptions where appropriate, summarizing the principal factors which make the offering one of high risk or speculative. These factors may be due to such matters as an absence of an operating history of the registrant, an absence of profitable operations in recent periods, an erratic financial history, the financial position of the registrant, or the nature of the business in which the registrant is engaged or proposes to engage. In this connection see In the Matter of Universal Camera Corporation, 19 S.E.C. 648 (1945) and Doman Helicopter, Inc., 41 S.E.C. 431 (1963).

Where there is substantial disparity between the public offering price and the effective cash cost to officers, directors, promoters and affiliated persons for shares acquired by them in a transaction which is currently significant, or which they have a right to acquire, there should be included a comparison of the public contribution under the proposed public offering and the effective cash contribution of such persons. In such cases, and in other instances where the extent of the dilution makes it appropriate, the following shall be given: (a) the net tangible book value per share before and after the distribution; (b) the amount of the increase in such net tangible book value per share attributable to the cash payments made by purchasers of the shares being offered; and (c) the amount of the immediate dilution from the public offering price which will be absorbed by such purchasers.

7. Dating of Prospectuses.

The date of the prospectus required by Rules 423 and 433 should be set forth on the cover page.

8. Pictorial or Graphic Representations in Prospectuses.

Ordinarily, photographic reproductions of management, principal properties or important products in prospectuses are not permissible, unless necessary to a fair understanding of the subject. The same is true of artists', architects' or engineers' conceptions or renderings, which may be misleading in that there is no assurance of completion of the structure or because of lack of accuracy of the conception or rendering. However, accurate maps or surveys are permissible where appropriate. Established corporate symbols or trademarks may be used, provided they do not create misleading impressions.

9. Promoters.

The term "promoters" is defined in Rule 405 and used in various forms. All persons coming within the definition of the term "promoters" may be referred to as "founders" or "organizers" or some other term provided the term used is reasonably descriptive of their activities and the information called for by the form as to such persons is disclosed.

10. Registration of Options, Warrants or Rights and Other Securities Issued or Sold to Underwriters.

Transferable options, warrants or rights and the stock to be issued upon the exercise thereof which are issued to underwriters in connection with a registered public offering are to be considered a part of such offering. Similarly, stock, or securities convertible into another security, sold to underwriters in connection with a registered public offering are to be considered a part of such offering. Accordingly, such options, warrants or rights and the stock which is subject thereto or such other security which is to be sold to underwriters must be registered along with the securities to be offered to the public, notwithstanding that it is represented that such options, warrants, rights, stock or other security have been acquired for investment and not with a view to the distribution thereof.

Where transferable options, warrants or rights are granted to underwriters by some person other than the issuer, at or about the time of the proposed registered offering, the same registration requirements apply. In such case, the registration statement should also be signed by such person as the issuer of the option warrants or rights, but it may be stated in the signature paragraph that such signature relates only to information regarding the options, warrants or rights.

The foregoing registration requirements apply whether the options, warrants or rights are exercisable immediately or are not exercisable until some future date.

Nontransferable options, warrants or rights granted to underwriters are not required to be registered but the stock subject thereto must be registered along with the securities to be offered to the public.

If registration is required in accordance with the foregoing and it is not contemplated that the security will be immediately distributed, the registration statement should include an appropriate undertaking substantially as follows:

"The registrant undertakes with respect to (identify security) issued (or to be issued) to underwriters, that (1) any prospectus revised to show the terms of offering of such shares (other than a transaction on a national securities exchange), and (2) any prospectus revised to comply with the requirements of Section 10(a)(3) of the Securities Act of 1933, will be filed as a post-effective amendment to the registration statement prior to any offering thereof; and that the effective date of each such amendment shall be deemed the effective date of the registration statement with respect to securities sold after such amendment shall have become effective."

(See also #17 and #36)

UNDERWRITING AND DISTRIBUTION

11. Finders.

The last sentence of Instruction 1 to Item 1 of Form S-1 requires appropriate disclosure on the cover page of the prospectus of any finder's fees or similar payments. Such disclosure should identify the finder and the nature of any relationship between him and the registrant, its officers, directors, promoters, principal stockholders and underwriters (including in each case, affiliates or associates thereof). Consideration should be given to all relevant circumstances in determining whether participation of the finder in the issuance and sale of the securities being offered is sufficient to constitute the finder an "underwriter" within the definition of that term in Section 2(11) of the Act. Ordinarily a finder whose principal function is to introduce a registrant to an underwriter for a cash fee, need not be identified as an "underwriter." If a finder receives securities for his services, the securities should be registered. Whenever the finder is deemed to be an underwriter by reason of the receipt of securities for services, or otherwise, he should be identified as such in the prospectus.

12. Over-the-Counter Trading in Rights or Warrants.

(Obsolete as of September 1, 1969.)

13. Market Quotations--Absence of Established Market.

If there is an established market for the securities to be registered, it would normally be appropriate to set forth in the prospectus the high and low sale prices of such securities (or in the case of trading in the over-the-counter market or in the absence of trading on an exchange, during a particular period, the high and low bid prices) for each quarterly period within the past two years and the nature of the market and source of the quotations. If the securities are traded on an exchange, the name of the exchange should also be given.

If there is no established trading market for the securities to be offered pursuant to the registration statement, the prospectus should so state in a prominent place, unless it is evident that no such market exists.

The existence of limited or sporadic quotations should not of itself be deemed to constitute an established trading market. If any known facts indicate the absence of an established trading market, reference to quotations in the prospectus should be qualified by appropriate explanation. See #53.

14. Underwriters' Compensation from Conversion of Funds into Foreign Currency.

In cases where an underwriter receives U.S. currency as a result of an offering but remits the proceeds to the issuer in a foreign currency, any material amount of profit accruing to the underwriter as a result of such conversion of the proceeds of the offering into a foreign currency may be considered as additional underwriting compensation and appropriate disclosure, per share and in the aggregate, should be made on the facing page of the prospectus.

15. Expenses of Issuance and Distribution.

The itemized statement of "other expenses of issuance and distribution" called for in Part II of the registration statement (e.g., see Item 23 of Form S-1) should include, as a separate item, any premium paid by the registrant or any selling security holder on any policy obtained in connection with the offering or sale of the securities which insures or indemnifies directors or officers against any liabilities they may incur in connection with the registration, offering or sale of the securities to be registered.

The total of such expenses, stated separately for the registrant and for the selling security holders (if any) as a group, should be set forth in a note to the net proceeds column of the underwriting table on the cover page of the prospectus.

16. Disclosure with Respect to Newly Organized Underwriting Firms.

Where an underwriter of a new or speculative issue of securities is newly organized or reactivated, or only recently registered as a broker-dealer, and especially where the principal function of such underwriter will be to sell the securities to be registered, or the promoters of the registrant are identified with the underwriter, these facts should be disclosed in the prospectus. Sufficient details should be given to allow full appreciation of the underwriter's experience and its relationship with the registrant, promoters and controlling persons.

17. Disclosure of Underwriting Discounts and Commissions.

In some instances the underwriters receive part of their underwriting discounts or commissions in a form the value of which is not easily reducible to a dollar per unit basis. This compensation may be in the form of options or warrants to purchase shares, expense allowances, continuing fees for services, first refusal on future financing, etc. When it is impracticable to furnish fully or precisely the required information with respect to such compensation on the cover page of the prospectus without rendering it difficult to read, only the most significant facts should be described thereon together with a reference to the page, or if given under a separate caption, then to the caption, of the prospectus where additional information with respect to such compensation is set forth.

Generally, it will be assumed for the purpose of disclosure that options, warrants, rights, stock or other securities sold or given to the underwriters or prospective underwriters within 12 months before the filing of the registration statement or proposed to be sold or given to them thereafter were issued in connection with such offering. Accordingly, the potential profits which may be received upon the sale of such options, warrants, rights, stock or other securities should be identified as additional underwriting compensation for such offering, whether or not such underwriters withdraw and other underwriters are substituted.

Not later than the time of filing the last amendment prior to the effective date of the registration statement, the registrant shall inform the Commission whether or not the amount of compensation to be allowed or paid to the underwriters, as described in the registration statement, has been cleared with the National Association of Securities Dealers, Inc.

(See also #10 and #36)

18. Original Issue Discount of Debt Securities.

Where debt securities are to be offered at a price below the par or face value thereof, or where a debt security is sold in a package with another security and the allocation of the sale price between the two securities may have the effect of offering the debt security at a price below its par or face value, the "discount" should be disclosed in the prospectus. The possible effect on the investor of the "original issue discount" provision of Section 1232 of the Internal Revenue Code should also be disclosed in the prospectus. If the provisions of Section 1232 are not deemed to be applicable, the registrant should so advise the staff at the time of filing the registration statement, or an amendment thereto.

19. Distribution of Preliminary Prospectus.

Rule 460 provides in substance that, in ruling upon requests for acceleration of the effective date of a registration statement, the Commission will consider whether an adequate distribution of the preliminary prospectus to underwriters and dealers who it is reasonably anticipated will participate in the proposed offering has been made a reasonable time in advance of the anticipated effective date of the registration statement. Accordingly, in each applicable case, the registrant should furnish to the Division, prior to or at the time of filing a request for acceleration pursuant to Rule 461, the following information with respect to the extent of the distribution of the preliminary prospectus: (1) the dates of distribution; (2) the number of prospective underwriters and dealers to whom they were furnished; (3) the number of prospectuses so distributed; and (4) the number of prospectuses distributed to others, identifying them in general terms.

The Commission has in some instances required a broader distribution of the prospectus as a condition to acceleration.

Distribution of preliminary prospectuses to dealers is not ordinarily a condition for acceleration in the case of offerings of securities to stockholders by subscription rights or otherwise, unless it is contemplated that the distribution will be made through dealers and the underwriters intend to make the offering during the stockholders' subscription period, in which case copies of the preliminary prospectus must be distributed to dealers prior to the effective date of the registration statement in the same fashion as is required in the case of other offerings through underwriters. Where the underwriters do not intend to offer the securities during the stockholders' subscription period, distribution to dealers of the preliminary prospectus is not required.

20. Mailing of Amended Preliminary Prospectus to Regional Offices.

Unmarked copies of the preliminary prospectus contained in any material amendment to the registration statement should be sent to the Commission's regional offices located at Room 1708 U. S. Courthouse & Federal Office Building, 219 South Dearborn Street, Chicago, Ill. 60604 and 26 Federal Plaza, New York, New York 10007.

USE OF PROCEEDS

21. Use of Proceeds.

Inclusion in a prospectus of a statement that management reserves the right to change the use of proceeds may give rise to a question as to whether the disclosures made in response to Item 3 of Form S-1 are bona fide. However, such reservation is permissible if its inclusion is due to certain contingencies which are adequately discussed in the prospectus in terms of an alternative use of proceeds to be followed in the event that the contingencies arise.

FINANCIAL DATA

22. Summary of Earnings.

The content of the summary of earnings is specified in general in the instructions to the pertinent items of the form. The necessity of disclosing items in addition to those specified in such instructions will depend upon the circumstances. These instructions cannot, of course, cover all situations which may arise nor is it practicable to set forth a statement of policy dealing specifically with all possible situations. The existence of any unusual conditions affecting the propriety of the presentation and the necessity for the inclusion of an additional previous period should be considered.

When the text of the prospectus contains a discussion of factors indicating an adverse change in operating results subsequent to the latest period included in the summary of earnings, the summary should call attention to the change, in a headnote or in a footnote, and refer to the place in the prospectus where it is discussed.

23. Current Financial Statements and Related Data.

The following is furnished as a guide for determining the need for "updating" financial statements and related data in registration statements under the Act and is a reaffirmation of the policies stated in Securities Act Release No. 4475, dated April 13, 1962:

(a) Financial Statements.

(1) Form S-1.

Registrants presently subject to the reporting requirements of the Securities Exchange Act of 1934 and other companies with a substantial record of earnings which publish financial information on a regular basis, should be prepared to add later information as to sales and net income on a current and comparable basis in a paragraph following the summary of earnings when such later information has been published or is to be published in an interim report prior to the effective date of the registration statement. Whether or not such a report is published, later sales and net income information on current and comparable prior year bases should be included in such a paragraph when an adverse trend is shown. Such disclosure is necessary regardless of the certified or noncertified status of the financial statements in the prospectus. It should be understood that when a fiscal year ends within 90 days prior to the date of filing and certified financial statements for the year are available for publication before the proposed effective date, such statements should be substituted for the interim statements in the registration statement as originally filed.

Companies registering for the first time with no previous record of publishing information, but with an established record of earnings and in a sound financial condition, should be prepared to furnish the above data compared with a similar period of the preceding year, if the amendment when effective would otherwise include data over four months old.

New registrants with no established record of earnings and old registrants currently showing losses or a weak financial condition should not only furnish the above data but be prepared to bring the financial statements up to the latest practicable date not more than 90 days prior to filing the amendment upon which it is expected the filing will become effective. If delay carries the date beyond the close of the fiscal year and by applying due diligence the registrant and its independent accountant can have an audit completed prior to the planned effective date, certified statements for the fiscal year should be substituted for interim statements whether or not the interim financial statements have been certified.

When later interim financial statements are to be furnished to supplement either fiscal year or interim statements which have been certified, the later statements would in the usual case be unaudited. However, when numerous or involved financial transactions have been effected since the date of the financial statements furnished or it is recognized that unusual conditions affect the determination of earnings, the Commission has indicated that later financial statements may be requested on a certified basis as a condition to acceleration under Section 8(a) of the Act.

(2) Forms S-2 and S-3

All financial statements on these forms are required to be certified. In all cases of extended delay later statements should be prepared so that at the expected effective date the statements are not over four months old.

(3) Forms S-7, S-8 and S-9.

In cases of unusual delay of effectiveness of the registration statement, consideration should be given to presenting such later financial data, including interim earnings, when such information has been published or issued to stockholders.

(4) Form S-11

Principles set forth above for Form S-1 should be applied to filings on this form as appropriate.

(b) Financial Data

Volume statistics, loss experience in insurance companies, bad debt and collection experience in finance, real estate and small loan companies, backlog and similar data should be brought up to date when later financial information is furnished.

24. Currencies in which Amounts are to be Stated by Foreign Issuers.

In connection with registration statements filed by foreign issuers, the question arises whether money amounts may be stated only in the currency of the domicile of the registrant or whether such amounts must also be stated in U. S. dollars. It is our practice to accept the statement of such money amounts in the currency of the registrant's domicile except that, where necessary to a clear understanding, the U. S. dollar equivalent should be shown in parallel columns or otherwise, as appropriate. In all cases, however, the exchange rate in effect in New York City as of the latest practicable date should be set forth at the beginning of the prospectus in prominent (preferably bold-face) type.

25. Manner of Showing Distributions by Real Estate Syndicates and Real Estate Investment Trusts.

Where distributions by real estate syndicates or real estate investment trusts represent, as is usually the case, both investment income and a return of capital, it is misleading to express such distributions in percentages, since such percentages indicate a rate of return in excess of the rate of return realized on the basis of investment income. In stating the amount of such distributions, the amount representing income and the amount representing return of capital should be clearly shown and should be computed on the accounting basis prescribed for financial statements filed with the Commission rather than on the basis used for income tax purposes, if different.

26. Statement of Dividend Policy.

Generally, objection will be made to a projection of future dividends in the prospectus. Objection ordinarily will not be made to a statement in the prospectus as to the policy of the board of directors of the registrant to declare dividends on a stated periodic basis, or that it will be the policy of the board of directors to declare as dividends a specified percentage of profits, provided no projection of dollar amounts is given and a further statement is made to the effect that there is no assurance as to future dividends since they are dependent upon earnings, the financial condition of the registrant and other factors. However, there is no objection to the registrant's stating the amount of dividends to be paid for the next succeeding dividend period if the amount to be paid has been determined.

Where a registrant has a record of paying no dividends although earnings indicate an ability to do so, the registrant should consider the question of its intention to pay cash dividends in the foreseeable future, and if no such intention exists, a statement of that fact should be set forth in the prospectus.

BUSINESS AND PROPERTY

27. Names of Customers and Competitors:

Item 9(b) of Form S-1 requires certain disclosure as to the nature of the market for the registrant's products or services and as to the registrant's competitive position in the industry. In connection with these disclosures the names of either customers or competitors are not required in the usual case. If the registrant voluntarily includes such names, no objection is ordinarily raised unless in the particular case the effect of including such names is misleading. If a substantial part of the business of the registrant is dependent upon a single customer, or a very few customers, the loss of any one of which would have a materially adverse effect on the registrant, the name of the customer or customers and other material facts with respect to their relationship, if any, to the registrant and the importance of the business to the registrant should be included.

28. Extractive Reserves.

Instruction 2 to Item 10 of Form S-1 and Item 5(a) of Form S-7 require that registrants engaged in extractive operations include in their prospectus, where appropriate, the quantitative amount of their estimated reserves. If appropriate, the current market price per barrel of oil, m.c.f. of gas, or the assay value per ton of ore may also be shown, but it is deemed inappropriate to show a dollar amount equal to the market price multiplied by the number of barrels of oil, m.c.f. of gas or tons of ore.

29. Disclosure of Material Long-term Leases.

In describing any property held under a material long-term lease, give the remaining term of years of the lease.

30. Disclosure of Principal Sources of Electric Revenues on Form S-9.

In registration statements filed on Form S-9 by electric utilities, the principal classes of service from which electric revenues are derived should be furnished in response to Item 3(b).

31. Disclosure of Recent Developments--Backlog.

If there has been a material change in the trend of sales or earnings of the registrant during the period for which financial statements are included in the prospectus, or subsequent to such period, the reason for the change should be adequately disclosed. (See #23 above)

Where material in the business of the registrant, information for a current period compared with a similar period twelve months earlier, and if significant, prior years, should be given with respect to backlog and levels of plant operation. In giving information as to backlog, the dollar amount of unfilled orders should represent only firm orders. However, there may be included as firm orders, government orders that are firm but not yet funded and contracts awarded but not yet signed, provided an appropriate footnote is added explaining the nature of such orders and the amount thereof. The portion of orders already included in sales or operating revenues on the basis of completion accounting should be excluded from the amount of backlog. There should be disclosed any seasonal aspects of the backlog and the total amount of any orders forming a part of such backlog not expected to be filled within the current fiscal year or, if sales for an interim period are shown, within the balance of such fiscal year following the end of such interim period.

SECURITIES TO BE REGISTERED

32. Liability of Shareholders to Laborers, Servants or Employees under State Law.

Statutes of several of the states impose joint and several liability on corporate shareholders for labor debts (i.e., debts, wages, and salaries due and owing to employees by the corporation). The potential liabilities imposed on shareholders by these statutes should be appropriately disclosed in the prospectus unless such disclosure would be immaterial because the financial resources of the registrant are such as to make it unlikely that the liability will ever be imposed.

33. Notice of Redemption of Convertible Securities or Callable Warrants.

Where a prospectus relates to convertible securities which are subject to redemption, or to stock purchase warrants which are callable, it should be stated at an appropriate place in the prospectus that the right to convert

or purchase will be lost unless it is exercised before the redemption or call. The kinds, frequency and timing of notice of the redemption or call should also be stated, including the cities or newspapers in which notice will be published. In the case of bearer securities which are convertible or callable, the prospectus should prominently caution investors to make appropriate arrangements to prevent loss of the right to convert or purchase, in the event of redemption, for instance, by regularly reading newspapers in which notice of the redemption or call may be published.

MANAGEMENT AND CONTROL

34. Executive Committee.

If the registrant has an executive committee, the members thereof should be indicated by a footnote or other appropriate means in connection with the disclosure required by Item 16 of Form S-1.

35. Identification of Members of Board of Directors Selected by the Underwriters.

As indicated in Securities Act Release No. 4475, dated April 13, 1962, the Commission has refused to accelerate the effective date of a registration statement where an underwriter has the right to designate a director and the person has not been designated but when designated may be a director, officer, partner, employee or affiliate of the underwriter. If the person to be designated will not be so related to the underwriter and the underwriter is not otherwise in a position to identify such person, then the prospectus should contain a representation so stating.

36. Effect of Issuance of Options or Warrants to Certain Persons.

If a material amount of options or warrants has been or is to be issued to promoters, underwriters, finders, principal stockholders, officers or directors, certain disclosure in regard thereto should be made in the prospectus, in addition to that required by Item 18 of Form S-1. Such additional disclosure should ordinarily include the following: that for the life of the options or warrants the holders thereof are given, at nominal cost, the opportunity to profit from a rise in the market for securities of the class subject thereto, with a resulting dilution in the interest of security holders; that the terms on which the issuer could obtain additional capital during that period may be adversely affected; and that the holders of such options or warrants might be expected to exercise them at a time when the issuer would, in all likelihood, be able to obtain any needed capital by a new offering of securities on terms more favorable than those provided for by the options or warrants. Similar disclosure should also be made where securities with conversion privileges are issued to the above persons.

(See also #10 and #17)

WRITTEN CONSENTS

37. Consents of Accountants.

Prospectuses frequently contain statements to the effect that the financial statements and related schedules contained in the prospectus and in the registration statement have been examined, and the summary of earnings and the historical financial information have been reviewed, by the independent public accountants and that such statements, schedules, summary and information are set forth upon the authority of the accountants as experts. In such cases the consent of the accountants to the use of their name in the manner indicated should be included in the registration statement in addition to their consent to the specific use of their name in connection with the earnings summary, the historical financial information and the use of their certificate with the financial statements and supporting schedules.

38. Consents of Attorneys.

Where a registration form requires as an exhibit an opinion of counsel as to the legality of the issue, the written consent of counsel furnishing the opinion must be filed with the registration statement. If any other attorney is also named as having passed upon the legality of the issue for the registrant, the written consent of such attorney must also be filed even though his opinion is not filed with the registration statement.

If any information contained in the registration statement, other than that referred to above, is stated to be furnished upon the authority of an attorney for the registrant, such attorney shall be named and his consent to being so named shall be filed as a part of the registration statement. Where the same attorney is named with respect to several parts of the registration statement, it is not necessary to furnish a separate consent with respect to each such part but the consent should be broad enough to cover all matters with respect to which the attorney is named as having acted.

Where an attorney is named as having acted for the underwriters or selling security holders, no consent will be required by reason of his being named as having acted in such capacity.

Where the opinion of one attorney relies upon the opinion of another attorney, the consent of the attorney who prepared the initial opinion need not be furnished even though he is named in the registration statement as an expert.

Where information, such as the nature of the registrant's title to its properties, is given on the basis of an opinion of counsel, the name of the counsel should be disclosed in the registration statement and his consent furnished. The name of such counsel need not be set forth at the particular place where the information based on his opinion is given, provided he is otherwise identified and his name disclosed elsewhere in the registration statement.

EXHIBITS

39. Charter Amendments Authorizing New Securities.

Certain forms require the filing with the registration statement of a copy of the registrant's charter with amendments, or as amended, and a copy of all constituent instruments defining the rights of the holders of securities being registered. Where it is impracticable for the registrant to file with the appropriate State authority, prior to the effective date of the registration statement, an amendment to the articles of incorporation authorizing the securities being registered, it will suffice for the registrant to file with the registration statement an exact copy of the proposed form of amendment to be filed with the State authority. If material changes are made after the copy is filed, an amended copy must be filed. The filing of an additional copy of the amendment after it has been filed with the State authority is not required unless there are additional changes.

Where the securities being registered are to be offered before the charter amendment authorizing them becomes effective, appropriate disclosure of that fact should be made in the prospectus.

40. Underwriting Agreements.

The filing with a registration statement of signed copies of the underwriting agreement is not required. All that is required is a complete copy of the contract as it will read when it is finally executed by the underwriters. If any material changes are made after such copy has been filed, it will be necessary to file an amended copy.

41. Specimen Bond.

In the case of a bond issue, a specimen bond should be filed if available. However, if a specimen is not available it is not necessary to file a copy of the bond if the full text of the bond is set forth in the indenture. In the latter case, however, a reference should be made in the list of exhibits to the pages of the indenture where the text of the bond is set forth, or to the indenture index where reference to such pages is made.

SUPPLEMENTAL INFORMATION

42. Reports or Memoranda Concerning the Registrant.

If, within the past twelve months, any engineering, management or similar report or memorandum relating to broad aspects of the business, operations or products of the registrant has been prepared for or by the registrant, any security holder named in answer to Item 19(a) of Form S-1, or any principal underwriter, as defined in Rule 405, of the securities being registered, or if any report or memorandum has been prepared for external use by the registrant or a principal underwriter in connection with the proposed offering, such report or memorandum should be furnished to the Division as supplemental information prior to any pre-filing conference or, if none, at the time of filing the registration statement, or as soon as practicable thereafter.

There should also be furnished at the same time a statement as to the actual or proposed use and distribution of such report or memorandum. Such statement should identify each class of persons who have received or will receive the report or memorandum, and state the number of copies distributed to each such class. If no such report or memorandum has been prepared, the Division should be so informed in writing at the time the report or memorandum would otherwise have been submitted.

43. Representations From Selling Security Holders.

When outstanding securities are registered to cover a proposed offering for the account of selling security holders, the registrant should forward to the Division a statement from each selling security holder (or in the case of a large group of selling security holders, from the principal members of the group) setting forth the reason or reasons for the sale of such securities. The statement should also contain a representation that such person is familiar with the registration statement and should set forth any material adverse information known to the selling security holder with regard to current and prospective operations of the registrant not disclosed in the prospectus (or a negative representation to such effect, if applicable).

44. Securities Act Exemption for Shares Subject to Options.

Registrants with employee stock option plans who have not registered the underlying stock should inform the Division by letter as supplemental information at the time of filing a registration statement covering securities of the same or other classes whether it is intended to register stock to be issued upon the exercise of the options. If registration is not contemplated, information specifying the exemption from the registration requirements intended to be relied upon and the pertinent facts supporting such claim should be submitted unless already supplied in Item 26 of Form S-1. Such information submitted should include: the approximate number of persons who may be eligible to receive options under the plan; their positions with the registrant and their general salary classification; the extent to which they meet the standards of S.E.C. v. Ralston Purina Co., 346 U.S. 119 (1953); and the nature of any restrictions on transfer and investment representations required. In addition, if any purchasers of option stock have resold or transferred their shares within the past three years, the circumstances of such dispositions, consistent with the claimed exemption, should be explained by the registrant in its letter. If no such dispositions have occurred, it should be so stated.

45. Information as to Over-the-counter Market for Securities to be Registered.

If there is an over-the-counter market for the outstanding securities of the same class as those to be registered, the following information should be furnished as supplemental information, on a separate page, at the time the registration statement is filed or not more than one week thereafter:

1. The number of holders of record, as of a recent date, of securities of the same class as those to be registered, excluding directors, officers and persons holding of record, or known by the registrant to own beneficially, more than 10% of the outstanding securities of such class. State separately, as of the same date, to the extent determinable, the number of such record holders holding the securities in "street" and bank nominee names.

2. The aggregate number of shares held of record, as of the same recent date, by all persons other than directors, officers and persons holding of record, or known by the registrant to own beneficially, more than 10% of the outstanding securities of such class. State separately as of the same date, to the extent determinable, the aggregate number of such shares held in "street" and bank nominee names.

3. The aggregate number of shares transferred on the records of the registrant or its transfer agent during the 6 months prior to the same recent date, other than shares subject to transfer restrictions.

4. To the extent known to the registrant or managing underwriter, the names of the most active marketmaker or marketmakers, if any, for the securities of the same class as those to be registered, during the last 6 months.

MISCELLANEOUS DISCLOSURES

46. Statement as to Indemnification.

(a) Indemnification of directors, officers or controlling persons.

Where, by charter, bylaw, contract, statute or otherwise, provision is made for indemnification by the registrant of any of its directors, officers or controlling persons, against liabilities arising under the Act and Note (a) to Rule 460 does not apply because acceleration of the effective date of the registration statement is not to be requested, and waivers have not been obtained, a brief reference to such provisions shall be made in the prospectus together with a statement in substantially the following form:

"Insofar as indemnification for liabilities arising under the Securities Act of 1933 may be permitted to directors, officers or persons controlling the registrant, pursuant to the foregoing provisions, the registrant has been informed that in the opinion of the Securities and Exchange Commission such indemnification is against public policy as expressed in the Act and is, therefore, unenforceable."

If Note (a) to Rule 460 applies, the waivers or undertakings required thereby are to be filed as a part of the registration statement but no statement need be made in the prospectus in regard to indemnification of directors, officers or persons controlling the registrant.

(b) Indemnification of underwriters or persons controlling them.

If the underwriting agreement provides for indemnification by the registrant of the underwriters or their controlling persons against liabilities arising under the Act, a brief description of such

indemnification provisions may be furnished in the body of the prospectus, rather than on the facing page thereof, but in such case a reference should be made on the facing page to the page on which or the caption under which the description is set forth.

(c) Insurance against liabilities under the Act.

Insurance against liabilities arising under the Act, whether the cost of such insurance is borne by the registrant, the insured or some other person, is not a bar to acceleration under Note (a) to Rule 460 and no waivers or undertakings need be furnished with respect thereto.

47. Enforceability of Civil Liabilities under the Act Against Foreign Persons.

In a registration statement of a foreign private registrant, the forepart of the prospectus should clearly state how the enforcement by investors of civil liabilities under the Act may be affected by the fact that the registrant is located in a foreign country, that certain of its officers and directors are residents of a foreign country, that certain underwriters or experts named in the registration statement are residents of a foreign country, and that all or a substantial portion of the assets of the registrant and of said persons are located outside the United States. Such disclosures should indicate: whether investors will be able to effect service of process within the United States upon such persons; whether investors will be able to enforce against such persons judgments obtained in United States courts predicated upon the civil liability provisions of the Act; whether the appropriate foreign courts would enforce judgments of United States courts obtained in actions against such persons predicated upon the civil liability provisions of the Act, and whether the appropriate foreign courts would enforce, in original actions, liabilities against such persons predicated solely upon the Act. If any portions of such disclosures are stated to be based upon an opinion of counsel, such counsel should be named in the prospectus and an appropriate manually-signed consent to the use of such name and opinion should be included in the registration statement.

48. Annual Reports to Security Holders.

The prospectus should disclose whether or not annual reports of the registrant will be furnished to security holders and whether or not such reports will contain certified financial statements. The nature and frequency of other reports to be issued by the registrant also should be disclosed. However, this disclosure is not required in the case of registrants required to send annual reports containing certified financial statements to security holders pursuant to the statutes or regulations administered by the Commission or pursuant to a listing agreement with a national securities exchange.

49. Revision of Prospectuses Where a Company and its Employee Plan Have Different Fiscal Years:

Where securities are registered under the Act for offering pursuant to an employee stock purchase, savings or similar plan, and the interests in the plan constitute a separate security, such interests are also required to be registered and appropriate financial statements of the plan must be included in the prospectus. In a number of these cases the fiscal year of the plan ends on a date different from that of the employer company, so that information with respect to the plan may become out of date for the purpose of Section 10(a)(3) of the Act prior to that relating to the company, or vice versa. The question has been raised whether the prospectus may continue to be used until up-to-date financial statements and other information is available for both the plan and the company.

In such a case after information with respect to the plan or the employer company becomes out of date it is not permissible to continue using a prospectus which does not contain the required up-to-date information. However, a registrant may file a post-effective amendment to the registration statement containing the required information and after the amendment becomes effective may continue to use the old prospectus with the up-to-date financial statements and other information attached, until the prospectus must be revised to include up-to-date financial statements and other information with respect to the plan or the employer company, as the case may be. A copy of the prospectus with up-to-date information attached need not be furnished to existing participants in the plan who have previously received a copy of the prospectus and who are otherwise furnished with a copy of such up-to-date information, provided the prospectus contains a statement to the effect that such financial statements are to be deemed to be incorporated therein by reference for all purposes of the Act and the rules and regulations thereunder.

50. Disclosure of Confidential Material to Other Government Agencies:

Rule 485 under the Act prescribes the procedure to be followed by registrants who request the Commission to accord confidential treatment to a contract (or portion thereof) on the grounds that public disclosure would impair the value of the contract and is not necessary for the protection of investors. In an application for such confidential treatment of a material contract or portion thereof, the applicant should state whether or not the applicant is willing to permit the disclosure of the contract to other governmental bodies. Such permission is one factor which will be considered by the Commission in ruling on the application.

51. Release of Price Data on Subscription Offerings by Listed Companies.

Regulations of the New York Stock Exchange, as well as the public interest, require that the material facts as to the security to be offered to stockholders through subscription rights shall be announced to the public before trading in the subscription rights is commenced on the Exchange. See Rule 135.

Information such as the interest rate, conversion ratio and subscription price is frequently omitted from the registration statement until the price amendment is filed. When such information has been set forth in an amendment on file with the Commission, there is no objection to the dissemination of this information through the facilities of the Exchange or the Dow Jones broad tape prior to the time the registration statement becomes effective.

52. Disclosure as to Listing on an Exchange.

Unless there is reasonable assurance that the securities to be offered will be acceptable to a securities exchange for listing, the prospectus may be misleading if it conveys the impression that the registrant may apply for listing of the securities on an exchange or that the underwriters may request the registrant to apply for such listing.

53. Secondary Distributions "at the Market".

The registration statement of Hazel Bishop Co., Inc. (File No. 2-16761) filed June 28, 1960, related to an offering "at the market" of a substantial block of securities in relation to the securities of the class outstanding by a group of 112 named selling stockholders. The Commission stated in a stop order opinion involving this offering, as follows (40 SEC 718, 735):

"In supplying registrant with much needed capital in late 1959 and early 1960, and proposing the resale of the shares thus acquired to the public, the original purchasers and their associates and transferees in fact were and are performing an underwriting function for registrant, a function normally performed by an underwriter-dealer group. However, none of the contractual safeguards designed for the protection of both buyer and seller ordinarily provided in the conventional distribution through professional underwriters and dealers are mentioned in the prospectus. The absence of any indication of these safeguards, the size of the group of selling stockholders, and various relationships among them lead us to be apprehensive that this large group of sellers may not be aware that various statutory provisions and rules which govern the conduct of underwriters and dealers will apply to them and their activities for the duration of the offering of their shares to the public."

The Commission was concerned primarily with the application of the anti-manipulative Rules 10b-2, 10b-6 and 10b-7 and their possible impact upon an "at the market" offering, and the need for prior delivery of a statutory prospectus beyond that contemplated by Rule 153.

The essential elements of this situation are the following:

- (a) Registration of an "at the market" offering by selling stockholders.

- (b) A substantial amount of securities to be offered in relation to the securities of the class outstanding (more than 10%).
- (c) No professional underwriter to act for the group or no conventional underwriting agreement, and
- (d) The offering includes securities owned by insiders or substantial holders.

I. Where the above elements are present and there is a limited group of selling shareholders or several groups of related shareholders, contractual arrangements should be entered into between the members of the respective groups and the issuer for the following purposes:

- (1) To comply with the aforesaid anti-manipulation rules (namely, not to buy other securities of the same class or solicit purchases by others) until the offering by all members of the group is completed.
- (2) To inform the exchange, the brokers and selling shareholders in the group when the distribution by the respective members of the group is over.

II. Where the above elements are present and there is a large group of unrelated sellers the issuer should notify such sellers of the applicable Commission rules and regulations.

III. There may be a combination of I and II above in a single registration statement.

The foregoing arrangements should be disclosed in the registration statement.

54. Misleading Character of Certain Registrants' Names
(See Release 33-5005, September 17, 1969.)

55. Prospectuses Relating to Interest in Oil and Gas Programs
(See Release 33-5036, January 19, 1970.)

For RELEASE Monday, January 19, 1970

SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549

SECURITIES ACT OF 1933
RELEASE NO. 5036

GUIDE FOR PREPARATION OF PROSPECTUSES RELATING
TO INTERESTS IN OIL AND GAS PROGRAMS

On August 27, 1969, the Securities and Exchange Commission published, in Securities Act Release No. 5001, a proposed guide concerning the preparation of prospectuses relating to public offerings of interests in oil and gas programs and invited interested persons to comment thereon. The letters received have been carefully considered in the preparation of the definitive guide.

The guide represents the views of the staff of the Commission's Division of Corporation Finance and the Commission has authorized its publication in order to bring these views to the attention of prospective registrants. The guide is designed to accomplish, to the extent feasible, uniformity in both the sequence of the disclosures and their general content. Thus it should serve to assist issuers in preparing registration statements on Form S-1, as well as offering circulars under Regulation A, involving oil and gas drilling programs and facilitate the understanding and analysis of such programs by investors and enable them more readily to compare one offering with another.

The guide is published as Guide No. 55 in the series of registration guides published December 9, 1968, in Securities Act Release No. 4936. The text of the guide follows.

55. Prospectuses Relating to Interests in Oil and Gas Programs

Disclosures in prospectuses relating to oil and gas drilling programs should appear in the sequence indicated below, except that the table of contents, required by paragraph (c) of Rule 421 under the Act, to be included in the forepart of the prospectus may be inserted at any appropriate place in the sequence of disclosures.

The following disclosures should be included under appropriate captions:

1. Summary of Program. There should be set forth briefly on the cover page of the prospectus a summary which should include the following: (1) Terms of Offering: State the title and general nature of the securities (interests in the proposed program) being offered; the maximum aggregate amount of the offering; the minimum aggregate amount necessary to initiate the program; the disposition of the funds raised if they are not sufficient for that purpose; the minimum subscription price; the period of the offering; any provisions for additional assessments; and a brief description of the proposed method of distribution, including the amount of any commission to be paid. If funds received from investors are not to be held in trust or in special account pending expenditure in the program, appropriate disclosures should be set forth including when appropriate reference to exposure

to claims of creditors of the custodian of the funds. The tabular presentation specified in Item 1 of Form S-1 may be omitted. (2) Compensation: Describe generally all cash or property interests that will be paid as compensation in connection with the program, including underwriting commission; (3) Participation in Costs and Revenues: Show the percentages of expenditures to be borne, respectively, by the investors and by other parties, who should be briefly identified, and the percentages of revenues to be payable, respectively, to investors and to other parties, who should be briefly identified; and (4) Application of Proceeds: Indicate the minimum dollar amount of net proceeds (excluding additional assessments) that will be available to finance the program and the proposed estimated percentages thereof to be used for financing the principal activities of the program, such as acreage acquisition, drilling of exploratory wells, drilling of development wells and purchase of producing properties.

2. The Risk Factors. The investor should be advised in a carefully organized series of short, concise paragraphs, under subcaptions where appropriate, of the risks he should consider before making an investment in the program and should include cross-reference to where in the prospectus further information may be found.

3. Definitions. Include an appropriate glossary of terms used in the prospectus which should not be inconsistent with their customary usage in the oil and gas industry.

4. Terms of the Offering. Describe the interests and the amount and terms of offering.

5. Additional Assessments. Describe those assessments which may be later required from investors either for completion of wells or for the drilling of additional wells and where available, historical information relating to past programs, of the registrant or its associates, should be shown, in tabular form, indicating for each program, the aggregate amount (excluding assessments) paid by investors, the aggregate amount of additional assessments separately required for (a) the completion of wells and (b) the drilling of additional wells.

6. Plan of Distribution. Describe how the interests being offered are to be sold, as well as arrangements for compensation.

7. Proposed Activities. Describe the proposed activities of the program in which the interests are being offered.

8. Application of Proceeds. Include an appropriate percentage estimate of the proceeds to be applied to the different purposes within each of the principal activities of the program, such as acreage acquisition, drilling of exploratory wells, drilling of development wells and the purchase of producing properties. Where possible, the information should be set forth in tabular form.

9. Participation in Costs and Revenues. Describe the arrangements and understandings with respect to the provision of funds for expenditures in connection with the program and with respect to participation in revenues from any production of minerals which may be realized. Where possible, the information should be set forth in tabular form.

10. Compensation. Describe, whether in the form of cash or property interests, the compensation for underwriting, managerial, and operational services to be rendered in connection with the program, as well as the sources from which such compensation will be paid. Where possible, the information should be set forth in tabular form.

11. Management. Include the disclosures required by Items 16 through 20 of Form S-1 as to, respectively, the management and operating companies.

12. Conflict of Interest. Describe all conflicts of interest which may arise in the operations of the program involving parties engaged in the management and operation of the program.

13. Prior Activities. Describe in tabular form the results of programs during at least the past ten years of the registrant or its associates, indicating in appropriate detail for each of the programs (1) the drilling results thereof, and (2) for, respectively, (a) the public investors and (b) others, the total investment in each of such programs and the recovery on investment to date and for the last three months of the period covered, together with any other information as may be appropriate.

14. Tax Aspects. Discuss the tax consequences of oil and gas exploration, drilling and production, as well as federal tax legislation which has been proposed. This may include, in tabular form, only historical information relating to past programs of the registrant or its associates, showing expenses deductible and income taxable.

15. Other captions should then follow, such as Competition, Limited Partnership Agreement, Agent Agreement, Exploration Agreement, and Operating Agreement, under which other required information is set forth.

By the Commission.

Orval L. DuBois
Secretary

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
OFFICIAL BUSINESS
RETURN AFTER FIVE DAYS



For RELEASE Thursday, February 3, 1972

SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549

Securities Act of 1933
Release No. 5231

THE DIVISION OF CORPORATION FINANCE'S PROCEDURES
DESIGNED TO CURTAIL TIME IN REGISTRATION
UNDER THE SECURITIES ACT OF 1933

On November 21, 1968, the Commission issued Securities Act Release No. 4934 in which it set forth certain procedures designed to reduce the backlog of registration statements processed by the Division of Corporation Finance which had as of that date reached an unprecedented high. The Division now faces a situation similar to that which existed in the fall of 1968. For the first half of fiscal 1972, 1632 registration statements were filed as compared to 1193 for the like period in fiscal 1971. Of the fiscal 1972 filings, 632 represent first time filings by issuers which have never before been subjected to the registration process and generally require more time consuming review by the staff, as compared to 352 for the first half of fiscal 1971. The Division's workload also has been materially increased by the number of reports and other documents filed under the Securities Exchange Act. For example, annual reports on Form 10-K in fiscal 1971 reached a level of 8,319 as compared to 6,064 in fiscal 1969. Notwithstanding this burdening workload, the Division's staff has not increased to any significant extent.

In view of the above circumstances, the Division has taken further steps as set forth below designed to curtail the time in registration. The Commission believes it appropriate to once again bring these existing procedures and the new ones to the attention of registrants, attorneys, accountants, underwriters, and others in the securities industry and to urge their cooperation in assuring that registration statements contain full and fair disclosure and are prepared in the public interest to present effective disclosure--to communicate--in order that public investors be protected.

Various Review Procedures

The Division employs four different review procedures in examining registration statements. It should be noted that the Division and not the registrant itself will determine which type of examination a registration statement will receive.

1. Deferred Review

The first category of procedures will come into operation when a supervisory staff official decides after initial analysis that the registration statement is so poorly prepared or otherwise presents problems so serious that review will be deferred since no further staff time would be justified in view of other staff responsibilities. Detailed comments will not be prepared or issued for to do so would delay the review of other registration statements which do not appear to contain comparable disclosure problems. Registrants will be duly notified. It will then be the responsibility of the particular registrant to consider whether to go forward, withdraw, or amend. Should the registrant decide to go forward without corrective steps, the staff will then make recommendations to the Commission for appropriate action.

2. Cursory Review

The second type of review involves advice to registrants that the staff has made only a cursory review of the registration statement and that no written or oral comments will be provided. In such cases, particularly with respect to companies which have never before been subject to the registration process, registrants will be requested to furnish as supplemental information letters from the chief executive officer of the issuer, the accountants, and the managing underwriter on behalf of all underwriters. These letters shall include representations that the respective persons are aware that the staff has made only a cursory rather than a detailed review of the registration statement and that such persons are also aware of their statutory responsibilities under the Securities Act. Registrants will be advised that, upon receipt of such assurances, the staff will recommend that the registration statement be declared effective. Generally with respect to a first time filing, the effective date will not be earlier than 20 days after the date of original filing.

3. Summary Review

The third category -- summary review -- involving a variation of the cursory treatment described in the preceding paragraph, will entail notification to the registrant that only a limited review of the registration material has been made and only such comments as may arise from such review will be furnished. Registrants will be requested to provide letters from the same individuals mentioned in the preceding paragraph containing similar representations. Registration statements reviewed in a summary fashion will be declared effective as described in the preceding paragraph upon receipt of both the above-mentioned assurances and upon satisfactory compliance with the limited comments of the staff.

4. Customary Review

In the final category of review, registration statements will receive a more complete accounting, financial and legal review.

Notwithstanding the type of review applied to a registration statement, the Commission hereby again advises registrants that the statutory burden of disclosure is on the issuer, its affiliates, the underwriter, accountants and other experts; that as a matter of law this burden cannot be shifted to the staff; and that the current workload is such that the staff cannot undertake additional review and comments. Attention is directed to the case of Escott v. BarChris Construction Corporation, et al., 283 F. Supp. 643 (DC, S.D.N.Y., 1968).

The Division recognizes that due to the utilization of gradations of review, certain disclosures may appear in particular prospectuses which do not appear in others. Such differences in disclosure will not, however, preclude the staff from commenting upon the presence or absence of specific disclosures in the review of other filings.

Need for Renewed Cooperation of the Bar, Accounting and Financial Communities

In addition to the measures to be adopted by the staff in its effort to reduce the time in registration, several steps can and should be taken by the issuers, counsels, underwriters, and accountants which will contribute significantly towards meeting that objective in a manner consistent with the protection of investors and the traditions of high standards of disclosure. Specifically, the Commission requests that such persons proceed as follows:

1. Readability

Prepare prospectuses with an emphasis on "readability" and "understandability". The function of a prospectus is to communicate through effective disclosure to the investor. Disclosure contained in a registration statement falls far short of its statutory purpose if organized and expressed in such a way as not to convey the required information to the investor in an understandable fashion. The following are some but by no means an inclusive list of suggestions to achieve this.

- a. Write short and simple sentences rather than complex ones.
- b. Do not clutter up the cover page.
- c. Use visual aids, such as tables and charts (also see Securities Act Release No. 5171 relating to pictorial and graphic representations).
- d. Where appropriate, include an introductory statement in the forepart of the prospectus which would enumerate in a clear, concise manner the specific factors which make the purchase of the securities one of high risk. The different risk factors should be broken out into separate paragraphs with a caption in bold face type which concisely identifies the risk described therein.
- e. In the case of lengthy or complex prospectuses, include a relatively short, readable summary in the forepart of the prospectus.

2. "Getting In Line"

Do not file a registration statement with the Commission which fails to meet the statutory standards in order to "get in line", in the expectation that the staff's comments will provide the requisite compliance with these standards.

3. Transmittal Letters

Submit a letter of transmittal with the registration statement, covering, among other matters, the following:

- a. Particular disclosure and accounting problems;
- b. A realistic desired time schedule for effectiveness of the registration statement. While the staff will endeavor to meet such time schedules, there is no assurance that this will occur; accordingly issuers should initially recognize this in terms of their planning;
- c. A representation by registrants using particular forms such as S-7, S-8, S-9 and S-16, that they have reviewed the various criteria for eligibility for a particular form and that such criteria have been satisfied;
- d. A statement that the registrant has reviewed and responded to all applicable paragraphs in Securities Act Release No. 4936. Reference should be made to the location in the prospectus of those responses. Where responses to certain apparently relevant paragraphs have not been made, a brief statement as to the reasons therefor should be provided. Registrants should be particularly conscious of the possible need to update financial statements and related data in accordance with the guidelines set forth in paragraph 23 of Release No. 4936;

- e. A statement, where applicable, that a repeat filing is modeled after a recent effective filing of the same issuer, together with an indication of the prior registration statement number and how the present filing differs from the previous one;
- f. A statement, where applicable, that the registrant is awaiting a legal opinion from counsel or a ruling from a federal or local agency at the time of filing, which is relevant to the contents of the registration statement. In this connection, reference should be made to the status of that opinion or ruling and the time of its anticipated receipt; and
- g. A statement, if applicable, pursuant to Securities Act Release No. 5196 as to whether all 1934 Act reports required to be filed have been filed and are complete.

4. Covering Letter Accompanying Amendments

Submit a letter with each amendment including among other matters the following:

- a. A response to each staff comment. Should a particular comment not be dealt with either in part or whole, the registrant should indicate the reasons therefor;
- b. A reproduced copy of the staff's letter of comment with the appropriate indication in the margin of that letter as to the page and paragraph in the registration statement on which the response to the comment is reflected;
- c. A description of what steps have been taken to comply with the provisions of Rule 15c2-8 under the Securities Exchange Act and Securities Act Release No. 4968 concerning distribution and redistribution of prospectuses; and
- d. A statement as to the status of any review of the underwriting arrangements by the NASD.

5. Redlining Amendments

The redlining of the amendment should be specific so as to highlight only the particular change made, as opposed to running a red mark down the margin of the entire page or lengthy paragraph in which a more narrow revision is contained.

6. Communications With the Staff

Exercise restraint in considering whether to communicate with members of the staff, in person or by telephone. While the communication of a material development which might have an impact on the filing is encouraged, inquiries as to the status of a filing tend to contribute to the delay of the processing of all filings. Persons calling should also identify immediately the registrant involved.

Invitation For Comments

Interested persons are invited to write directly to Alan B. Levenson, Director, Division of Corporation Finance with any suggestions or comments designed to improve administration of the review process or to achieve greater uniformity of treatment.

For RELEASE Monday, August 16, 1971

SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549

SECURITIES ACT OF 1933
Release No. 5180

GUIDELINES FOR THE RELEASE OF INFORMATION
BY ISSUERS WHOSE SECURITIES ARE IN REGISTRATION

The Commission today took note of situations when issuers whose securities are "in registration" 1/ may have refused to answer legitimate inquiries from stockholders, financial analysts, the press or other persons concerning the company or some aspect of its business. The Commission hereby emphasizes that there is no basis in the securities acts or in any policy of the Commission which would justify the practice of non-disclosure of factual information by a publicly held company on the grounds that it has securities in registration under the Securities Act of 1933 ("Act"). Neither a company in registration nor its representatives should instigate publicity for the purpose of facilitating the sale of securities in a proposed offering. Further, any publication of information by a company in registration other than by means of a statutory prospectus should be limited to factual information and should not include such things as predictions, projections, forecasts or opinions with respect to value.

A basic purpose of the Act and the Securities Exchange Act of 1934 is to require dissemination of adequate and accurate information concerning issuers and their securities in connection with the offer or sale of securities to the public, and the publication periodically of material business and financial facts, knowledge of which is essential to an informed trading market in such securities. It has been asserted that the increasing obligations and incentives of corporations to make timely disclosures concerning their affairs creates a possible conflict with statutory restrictions on publication of information concerning a company which has securities in registration. As the Commission has stated in previously issued releases this conflict may be more apparent than real. Disclosure of factual information in response to inquiries or resulting from a duty to make prompt disclosure under the antifraud provisions of the securities acts or the timely disclosure policies of self-regulatory organizations, at a time when a registered offering of securities is contemplated or in process, can and should be effected in a manner which will not unduly influence the proposed offering. 2/

1/ "In registration" is used herein to refer to the entire process of registration, at least from the time an issuer reaches an understanding with the broker-dealer which is to act as managing underwriter prior to the filing of a registration statement and the period of 40 to 90 days during which dealers must deliver a prospectus.

2/ Under Rule 135, as recently amended by Securities Act Release No. 5101, for example, a notice given by an issuer that it proposes to make a public

Statutory Requirements

In order for issuers and their representatives to avoid problems in responding to inquiries, it is essential that such persons be familiar with the statutory requirements governing this area. Generally speaking, Section 5(c) of the Act makes it unlawful for any person directly or indirectly to make use of any means or instruments of interstate commerce or of the mails to offer to sell a security unless a registration statement has been filed with the Commission as to such security. Questions arise from time to time because many persons do not realize that the phrase "offer to sell" is broadly defined by the Act and has been liberally construed by the courts and Commission. For example, the publication of information and statements, and publicity efforts, made in advance of a proposed financing which have the effect of conditioning the public mind or arousing public interest in the issuer or in its securities constitutes an offer in violation of the Act. The same holds true with respect to publication of information which is part of a selling effort between the filing date and the effective date of a registration statement.

Section 5(a) of the Act makes it unlawful to sell a security unless a registration statement with respect to such security has become effective. Section 5(b) makes it unlawful to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to transmit a prospectus with respect to any security as to which a registration statement has been filed unless such prospectus contains the information specified by Section 10 of the Act. Pitfalls may be encountered because the term "prospectus" has a broad meaning. The Act defines prospectus to include any notice, circular, advertisement, letter or communication written or by radio or television, which offers any security for sale except that any communication sent after the effective date of a registration statement shall not be deemed a prospectus if, prior to or at the same time with such a communication, a written prospectus meeting the requirements of Section 10 3/ of the Act was sent or given. 4/

offering of securities to be registered under the Act is not deemed to constitute an offer of such securities for sale if the notice states that the offering will be made only by means of a prospectus and contains only certain specified information.

- 3/ Such a prospectus would contain information concerning, among other things, the issuer's financial condition, business, property, management, and certain information about the offering including the manner of the offering and the intended use of the proceeds received.
- 4/ However, Section 2(10) of the Act and Rule 134 promulgated pursuant thereto exclude from the term "prospectus" the use of the "Tombstone ad" and the "identifying statement" described thereunder. Furthermore, Rules 433, 434 and 434A relate to the use of preliminary and summary prospectuses.

Guidelines

The Commission strongly suggests that all issuers establish internal procedures designed to avoid problems relating to the release of corporate information when in registration. As stated above, issuers and their representatives should not initiate publicity when in registration, but should nevertheless respond to legitimate inquiries for factual information about the company's financial condition and business operations. Further, care should be exercised so that, for example, predictions, projections, forecasts, estimates and opinions concerning value are not given with respect to such things, among other, as sales and earnings and value of the issuer's securities.

It has been suggested that the Commission promulgate an all inclusive list of permissible and prohibited activities in this area. This is not feasible for the reason that determinations are based upon the particular facts of each case. However, the Commission as a matter of policy encourages the flow of factual information to shareholders and the investing public. Issuers in this regard should:

1. Continue to advertise products and services.
2. Continue to send out customary quarterly, annual and other periodic reports to stockholders.
3. Continue to publish proxy statements and send out dividend notices.
4. Continue to make announcements to the press with respect to factual business and financial developments; i.e., receipt of a contract, the settlement of a strike, the opening of a plant, or similar events of interest to the community in which the business operates.
5. Answer unsolicited telephone inquiries from stockholders, financial analysts, the press and others concerning factual information.
6. Observe an "open door" policy in responding to unsolicited inquiries concerning factual matters from securities analysts, financial analysts, security holders, and participants in the communications field who have a legitimate interest in the corporation's affairs.
7. Continue to hold stockholder meetings as scheduled and to answer shareholders' inquiries at stockholder meetings relating to factual matters.

In order to curtail problems in this area, issuers in this regard should avoid:

1. Issuance of forecasts, projections, or predictions relating but not limited to revenues, income, or earnings per share.
2. Publishing opinions concerning values.

In the event a company publicly releases material information concerning new corporate developments during the period that a registration statement is pending, the registration statement should be amended at or prior to the time the information is released. If this is not done and such information is publicly released through inadvertance, the pending registration statement should be promptly amended to reflect such information.

The determination of whether an item of information or publicity could be deemed to constitute an offer - a step in the selling effort - in violation of Section 5 must be made by the issuer in the light of all the facts and circumstances surrounding each case. The Commission recognizes that questions may arise from time to time with respect to the release of information by companies in registration and, while the statutory obligation always rests with the company and can never be shifted to the staff, the staff will be available for consultation concerning such questions. It is not the function of the staff to draft corporate press releases. If a company, however, desires to consult with the staff as to the application of the statutory requirements to a particular case, the staff will continue to be available, and in this regard the pertinent facts should be set forth in written form and submitted in sufficient time to allow due consideration.

By the Commission.

Theodore L. Humes
Associate Secretary

For RELEASE Monday, August 16, 1971

SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549

SECURITIES ACT OF 1933
Release No. 5180

GUIDELINES FOR THE RELEASE OF INFORMATION
BY ISSUERS WHOSE SECURITIES ARE IN REGISTRATION

The Commission today took note of situations when issuers whose securities are "in registration" 1/ may have refused to answer legitimate inquiries from stockholders, financial analysts, the press or other persons concerning the company or some aspect of its business. The Commission hereby emphasizes that there is no basis in the securities acts or in any policy of the Commission which would justify the practice of non-disclosure of factual information by a publicly held company on the grounds that it has securities in registration under the Securities Act of 1933 ("Act"). Neither a company in registration nor its representatives should instigate publicity for the purpose of facilitating the sale of securities in a proposed offering. Further, any publication of information by a company in registration other than by means of a statutory prospectus should be limited to factual information and should not include such things as predictions, projections, forecasts or opinions with respect to value.

A basic purpose of the Act and the Securities Exchange Act of 1934 is to require dissemination of adequate and accurate information concerning issuers and their securities in connection with the offer or sale of securities to the public, and the publication periodically of material business and financial facts, knowledge of which is essential to an informed trading market in such securities. It has been asserted that the increasing obligations and incentives of corporations to make timely disclosures concerning their affairs creates a possible conflict with statutory restrictions on publication of information concerning a company which has securities in registration. As the Commission has stated in previously issued releases this conflict may be more apparent than real. Disclosure of factual information in response to inquiries or resulting from a duty to make prompt disclosure under the antifraud provisions of the securities acts or the timely disclosure policies of self-regulatory organizations, at a time when a registered offering of securities is contemplated or in process, can and should be effected in a manner which will not unduly influence the proposed offering. 2/

1/ "In registration" is used herein to refer to the entire process of registration, at least from the time an issuer reaches an understanding with the broker-dealer which is to act as managing underwriter prior to the filing of a registration statement and the period of 40 to 90 days during which dealers must deliver a prospectus.

2/ Under Rule 135, as recently amended by Securities Act Release No. 5101, for example, a notice given by an issuer that it proposes to make a public

Statutory Requirements

In order for issuers and their representatives to avoid problems in responding to inquiries, it is essential that such persons be familiar with the statutory requirements governing this area. Generally speaking, Section 5(c) of the Act makes it unlawful for any person directly or indirectly to make use of any means or instruments of interstate commerce or of the mails to offer to sell a security unless a registration statement has been filed with the Commission as to such security. Questions arise from time to time because many persons do not realize that the phrase "offer to sell" is broadly defined by the Act and has been liberally construed by the courts and Commission. For example, the publication of information and statements, and publicity efforts, made in advance of a proposed financing which have the effect of conditioning the public mind or arousing public interest in the issuer or in its securities constitutes an offer in violation of the Act. The same holds true with respect to publication of information which is part of a selling effort between the filing date and the effective date of a registration statement.

Section 5(a) of the Act makes it unlawful to sell a security unless a registration statement with respect to such security has become effective. Section 5(b) makes it unlawful to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to transmit a prospectus with respect to any security as to which a registration statement has been filed unless such prospectus contains the information specified by Section 10 of the Act. Pitfalls may be encountered because the term "prospectus" has a broad meaning. The Act defines prospectus to include any notice, circular, advertisement, letter or communication written or by radio or television, which offers any security for sale except that any communication sent after the effective date of a registration statement shall not be deemed a prospectus if, prior to or at the same time with such a communication, a written prospectus meeting the requirements of Section 10 3/ of the Act was sent or given. 4/

offering of securities to be registered under the Act is not deemed to constitute an offer of such securities for sale if the notice states that the offering will be made only by means of a prospectus and contains only certain specified information.

- 3/ Such a prospectus would contain information concerning, among other things, the issuer's financial condition, business, property, management, and certain information about the offering including the manner of the offering and the intended use of the proceeds received.
- 4/ However, Section 2(10) of the Act and Rule 134 promulgated pursuant thereto exclude from the term "prospectus" the use of the "Tombstone ad" and the "identifying statement" described thereunder. Furthermore, Rules 433, 434 and 434A relate to the use of preliminary and summary prospectuses.

Guidelines

The Commission strongly suggests that all issuers establish internal procedures designed to avoid problems relating to the release of corporate information when in registration. As stated above, issuers and their representatives should not initiate publicity when in registration, but should nevertheless respond to legitimate inquiries for factual information about the company's financial condition and business operations. Further, care should be exercised so that, for example, predictions, projections, forecasts, estimates and opinions concerning value are not given with respect to such things, among other, as sales and earnings and value of the issuer's securities.

It has been suggested that the Commission promulgate an all inclusive list of permissible and prohibited activities in this area. This is not feasible for the reason that determinations are based upon the particular facts of each case. However, the Commission as a matter of policy encourages the flow of factual information to shareholders and the investing public. Issuers in this regard should:

1. Continue to advertise products and services.
2. Continue to send out customary quarterly, annual and other periodic reports to stockholders.
3. Continue to publish proxy statements and send out dividend notices.
4. Continue to make announcements to the press with respect to factual business and financial developments; i.e., receipt of a contract, the settlement of a strike, the opening of a plant, or similar events of interest to the community in which the business operates.
5. Answer unsolicited telephone inquiries from stockholders, financial analysts, the press and others concerning factual information.
6. Observe an "open door" policy in responding to unsolicited inquiries concerning factual matters from securities analysts, financial analysts, security holders, and participants in the communications field who have a legitimate interest in the corporation's affairs.
7. Continue to hold stockholder meetings as scheduled and to answer shareholders' inquiries at stockholder meetings relating to factual matters.

In order to curtail problems in this area, issuers in this regard should avoid:

1. Issuance of forecasts, projections, or predictions relating but not limited to revenues, income, or earnings per share.
2. Publishing opinions concerning values.

In the event a company publicly releases material information concerning new corporate developments during the period that a registration statement is pending, the registration statement should be amended at or prior to the time the information is released. If this is not done and such information is publicly released through inadvertance, the pending registration statement should be promptly amended to reflect such information.

The determination of whether an item of information or publicity could be deemed to constitute an offer - a step in the selling effort - in violation of Section 5 must be made by the issuer in the light of all the facts and circumstances surrounding each case. The Commission recognizes that questions may arise from time to time with respect to the release of information by companies in registration and, while the statutory obligation always rests with the company and can never be shifted to the staff, the staff will be available for consultation concerning such questions. It is not the function of the staff to draft corporate press releases. If a company, however, desires to consult with the staff as to the application of the statutory requirements to a particular case, the staff will continue to be available, and in this regard the pertinent facts should be set forth in written form and submitted in sufficient time to allow due consideration.

By the Commission.

Theodore L. Humes
Associate Secretary

For RELEASE Monday, August 16, 1971

SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549

SECURITIES ACT OF 1933
Release No. 5180

GUIDELINES FOR THE RELEASE OF INFORMATION
BY ISSUERS WHOSE SECURITIES ARE IN REGISTRATION

The Commission today took note of situations when issuers whose securities are "in registration" 1/ may have refused to answer legitimate inquiries from stockholders, financial analysts, the press or other persons concerning the company or some aspect of its business. The Commission hereby emphasizes that there is no basis in the securities acts or in any policy of the Commission which would justify the practice of non-disclosure of factual information by a publicly held company on the grounds that it has securities in registration under the Securities Act of 1933 ("Act"). Neither a company in registration nor its representatives should instigate publicity for the purpose of facilitating the sale of securities in a proposed offering. Further, any publication of information by a company in registration other than by means of a statutory prospectus should be limited to factual information and should not include such things as predictions, projections, forecasts or opinions with respect to value.

A basic purpose of the Act and the Securities Exchange Act of 1934 is to require dissemination of adequate and accurate information concerning issuers and their securities in connection with the offer or sale of securities to the public, and the publication periodically of material business and financial facts, knowledge of which is essential to an informed trading market in such securities. It has been asserted that the increasing obligations and incentives of corporations to make timely disclosures concerning their affairs creates a possible conflict with statutory restrictions on publication of information concerning a company which has securities in registration. As the Commission has stated in previously issued releases this conflict may be more apparent than real. Disclosure of factual information in response to inquiries or resulting from a duty to make prompt disclosure under the antifraud provisions of the securities acts or the timely disclosure policies of self-regulatory organizations, at a time when a registered offering of securities is contemplated or in process, can and should be effected in a manner which will not unduly influence the proposed offering. 2/

1/ "In registration" is used herein to refer to the entire process of registration, at least from the time an issuer reaches an understanding with the broker-dealer which is to act as managing underwriter prior to the filing of a registration statement and the period of 40 to 90 days during which dealers must deliver a prospectus.

2/ Under Rule 135, as recently amended by Securities Act Release No. 5101, for example, a notice given by an issuer that it proposes to make a public

Statutory Requirements

In order for issuers and their representatives to avoid problems in responding to inquiries, it is essential that such persons be familiar with the statutory requirements governing this area. Generally speaking, Section 5(c) of the Act makes it unlawful for any person directly or indirectly to make use of any means or instruments of interstate commerce or of the mails to offer to sell a security unless a registration statement has been filed with the Commission as to such security. Questions arise from time to time because many persons do not realize that the phrase "offer to sell" is broadly defined by the Act and has been liberally construed by the courts and Commission. For example, the publication of information and statements, and publicity efforts, made in advance of a proposed financing which have the effect of conditioning the public mind or arousing public interest in the issuer or in its securities constitutes an offer in violation of the Act. The same holds true with respect to publication of information which is part of a selling effort between the filing date and the effective date of a registration statement.

Section 5(a) of the Act makes it unlawful to sell a security unless a registration statement with respect to such security has become effective. Section 5(b) makes it unlawful to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to transmit a prospectus with respect to any security as to which a registration statement has been filed unless such prospectus contains the information specified by Section 10 of the Act. Pitfalls may be encountered because the term "prospectus" has a broad meaning. The Act defines prospectus to include any notice, circular, advertisement, letter or communication written or by radio or television, which offers any security for sale except that any communication sent after the effective date of a registration statement shall not be deemed a prospectus if, prior to or at the same time with such a communication, a written prospectus meeting the requirements of Section 10 3/ of the Act was sent or given. 4/

offering of securities to be registered under the Act is not deemed to constitute an offer of such securities for sale if the notice states that the offering will be made only by means of a prospectus and contains only certain specified information.

- 3/ Such a prospectus would contain information concerning, among other things, the issuer's financial condition, business, property, management, and certain information about the offering including the manner of the offering and the intended use of the proceeds received.
- 4/ However, Section 2(10) of the Act and Rule 134 promulgated pursuant thereto exclude from the term "prospectus" the use of the "Tombstone ad" and the "identifying statement" described thereunder. Furthermore, Rules 433, 434 and 434A relate to the use of preliminary and summary prospectuses.

Guidelines

The Commission strongly suggests that all issuers establish internal procedures designed to avoid problems relating to the release of corporate information when in registration. As stated above, issuers and their representatives should not initiate publicity when in registration, but should nevertheless respond to legitimate inquiries for factual information about the company's financial condition and business operations. Further, care should be exercised so that, for example, predictions, projections, forecasts, estimates and opinions concerning value are not given with respect to such things, among other, as sales and earnings and value of the issuer's securities.

It has been suggested that the Commission promulgate an all inclusive list of permissible and prohibited activities in this area. This is not feasible for the reason that determinations are based upon the particular facts of each case. However, the Commission as a matter of policy encourages the flow of factual information to shareholders and the investing public. Issuers in this regard should:

1. Continue to advertise products and services.
2. Continue to send out customary quarterly, annual and other periodic reports to stockholders.
3. Continue to publish proxy statements and send out dividend notices.
4. Continue to make announcements to the press with respect to factual business and financial developments; i.e., receipt of a contract, the settlement of a strike, the opening of a plant, or similar events of interest to the community in which the business operates.
5. Answer unsolicited telephone inquiries from stockholders, financial analysts, the press and others concerning factual information.
6. Observe an "open door" policy in responding to unsolicited inquiries concerning factual matters from securities analysts, financial analysts, security holders, and participants in the communications field who have a legitimate interest in the corporation's affairs.
7. Continue to hold stockholder meetings as scheduled and to answer shareholders' inquiries at stockholder meetings relating to factual matters.

In order to curtail problems in this area, issuers in this regard should avoid:

1. Issuance of forecasts, projections, or predictions relating but not limited to revenues, income, or earnings per share.
2. Publishing opinions concerning values.

In the event a company publicly releases material information concerning new corporate developments during the period that a registration statement is pending, the registration statement should be amended at or prior to the time the information is released. If this is not done and such information is publicly released through inadvertance, the pending registration statement should be promptly amended to reflect such information.

The determination of whether an item of information or publicity could be deemed to constitute an offer - a step in the selling effort - in violation of Section 5 must be made by the issuer in the light of all the facts and circumstances surrounding each case. The Commission recognizes that questions may arise from time to time with respect to the release of information by companies in registration and, while the statutory obligation always rests with the company and can never be shifted to the staff, the staff will be available for consultation concerning such questions. It is not the function of the staff to draft corporate press releases. If a company, however, desires to consult with the staff as to the application of the statutory requirements to a particular case, the staff will continue to be available, and in this regard the pertinent facts should be set forth in written form and submitted in sufficient time to allow due consideration.

By the Commission.

Theodore L. Humes
Associate Secretary

For RELEASE Wednesday, December 30, 1970

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

SECURITIES ACT OF 1933
Release No. 5121

USE OF LEGENDS AND STOP-TRANSFER INSTRUCTIONS
AS EVIDENCE OF NON-PUBLIC OFFERING

The Securities and Exchange Commission has authorized the publication of the following statement which sets forth the policy of the Commission's Division of Corporation Finance in connection with the availability of the exemption under Section 4(2) from the registration provisions of the Securities Act of 1933. Section 4(2) of the Act provides for an exemption for "transactions by an issuer not involving any public offering," the so-called "private offering exemption."

Whether the transaction is one not involving any public offering is essentially a question of fact and necessitates a consideration of all the surrounding circumstances, including such factors as the relationship between the offerees and the issuer, the nature, scope, size, type and manner of the offering. The availability of the exemption turns on the question of "...the need of the offerees for the protection afforded by registration." See S.E.C. v. Ralston Purina Company, 346 U.S. 119 (1953) and Securities Act Release No. 4552 (1962).

An important factor to be considered is whether the securities offered have come to rest in the hands of the initially informed group or whether the purchasers are merely conduits for a wider distribution. It is essential that the issuer of the securities take careful precautions to assure that a public offering does not result through resales of securities purchased in transactions meeting the tests set forth in the Ralston Purina case, for, if in fact the purchasers do acquire the securities with a view to distribution, the seller assumes the risk of possible violation of the registration requirements of the Act and consequent civil and criminal liabilities.

These possibilities have led to the practice whereby issuers procure from the initial purchasers representations that they have acquired the securities for investment. A statement from an initial purchaser that he is purchasing for investment is not conclusive as to his actual intent. However, since the terms of an exemption are to be strictly construed against a claimant who has the burden of proving its availability, in many cases the issuer has placed a legend on such securities and stop-transfer instructions have been issued to the transfer agent. These precautions - placing the legend on the securities and issuing the stop-transfer orders - are not to be regarded as a basis for exemption, but they have proved in many cases to be an effective means of preventing illegal distributions. The use of the legend also alerts the buyer to the restricted character of the securities he has acquired and thus calls attention to material facts which assist in the protection of public investors.

The Legal and Compliance Committee of the Association of Stock Exchange Firms has recommended on a number of occasions that the Exchanges adopt a requirement that issuers of listed securities legend certificates that represent securities issued under an investment restriction. The American Stock Exchange requires that investment stock be legended because it feels that this restrictive legend would aid brokers in carrying out their responsibilities under the Exchange's Rule 411 which requires members to use diligence to learn the essential facts relative to every customer and to every order or account accepted.

The Division will regard the presence or absence of an appropriate legend and stop-transfer instructions as a factor in considering whether the circumstances surrounding the offering are consistent with the exemption under Section 4(2) of the Act. Consequently, issuers are urged to stamp or print on the face of certificates or other instruments evidencing restricted securities a conspicuous legend referring to the fact that the securities have not been registered under the Securities Act of 1933 and may be offered and sold only if registered pursuant to the provisions of that Act or if an exemption from registration is available. Issuers are also urged to issue stop-transfer instructions to prevent the transfer of the securities in such cases.

By the Commission.

Orval L. DuBois
Secretary

U.S. Securities and Exchange Commission
POSTAGE & FEES PAID



UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
OFFICIAL BUSINESS
RETURN AFTER FIVE DAYS

For RELEASE Thursday, November 19, 1970

SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549

SECURITIES ACT OF 1933
Release No. 5101

SECURITIES EXCHANGE ACT OF 1934
Release No. 9010

ADOPTION OF RULES RELATING TO PUBLICATION OF INFORMATION AND DELIVERY
OF PROSPECTUS BY BROKER-DEALERS PRIOR TO OR AFTER THE FILING
OF A REGISTRATION STATEMENT UNDER THE SECURITIES ACT OF 1933

The Securities and Exchange Commission has adopted rules under the Securities Act of 1933 and the Securities Exchange Act of 1934 designed to establish standards for determining circumstances under which broker-dealers may publish certain information about an issuer which proposes to or has registered securities under the 1933 Act, and also to clarify a dealer's obligation to deliver prospectuses under Section 4(3) of that Act, and the antifraud provisions of the 1934 Act. The Commission gave notice it proposed to adopt such rules on October 7, 1969, in Securities Act Release 5010.

Information, opinions or recommendations by a broker-dealer about securities of an issuer proposing to register securities under the Securities Act of 1933 for a public offering or having securities so registered, may constitute an offer to sell such securities within the meaning of Sections 2(3) and 5 of that Act, particularly when the broker-dealer is to participate in the distribution as an underwriter or selling group member. Publishing such information may result in a violation of Section 5 of the Act.

It is the purpose of the adopted rules to provide guidance to broker-dealers and to alleviate such requirements where it appears that the purposes and policies of the Act will not be prejudiced while assuring that persons engaged in the distribution of a registered offering and their customers will be supplied with the disclosure afforded by the statutory prospectus.

Summary of Rules Adopted under the Securities Act of 1933

Rule 135. Amendments to this rule permit publishing a notice that an issuer proposes to make a cash offering of securities to be registered under the 1933 Act. The requirement that such notices be sent 60 days prior to the record date or the proposed date of the initial offering has been deleted. The language of the rule has been revised and simplified.

Rule 137. This new rule is designed to clarify the status of dealers not participating in a distribution. It permits publication and distribution by a dealer in the regular course of business of information, opinions, or recommendations regarding securities of a reporting company which has filed or proposes to file a registration statement under the Act.

Rule 138. New Rule 138 permits a broker-dealer participating in an offering of non-convertible senior securities registered on Form S-7 or S-9 to publish opinions or recommendations concerning the issuer's common stock, and vice versa.

Rule 139. New Rule 139 permits a broker-dealer participating in an offering to publish at regular intervals, as part of a comprehensive list of securities, opinions or recommendations concerning the issuer provided it is a reporting company. The opinion or recommendation, however, must not be given special prominence, and must not be more favorable than the last previous opinion distributed before the broker-dealer became a participant.

Rule 174. The amendments to this rule eliminate the prospectus delivery requirement for dealers, other than participating dealers selling any unsold participation, during the 40 or 90 day period after the effective date of the registration statement or the commencement of the offering, whichever is later, with respect to sales of securities of issuers required to file reports under the Securities Exchange Act of 1934.

Summary of Rule Adopted under the Securities Exchange Act of 1934

Rule 15c2-8. This is a new rule under the Securities Exchange Act of 1934 relating to the distribution of preliminary and final prospectuses. The rule provides that a broker-dealer participating in a distribution must take reasonable steps to see to it that any person desiring a copy of a preliminary or final prospectus receives a copy. Each salesman who is expected to offer the securities must receive a copy of the preliminary prospectus and, if he is expected to offer the securities after the effective date of the registration statement, he must receive a copy of the final prospectus. The managing underwriter must take reasonable steps to see that broker-dealers participating in the distribution receive a sufficient number of copies of the prospectus to comply with the rule and with Section 5(b) of the Securities Act of 1933.

The text of the new and amended rules follows:

Rule 135. Notice of Certain Proposed Offerings.

(a) For the purpose only of Section 5 of the Act, a notice given by an issuer that it proposes to make a public offering of securities to be registered under the Act shall not be deemed to offer any securities for sale if such notice states that the offering will be made only by means of a prospectus and contains no more than the following additional information:

- (1) The name of the issuer;

(2) The title, amount and basic terms of the securities proposed to be offered, the amount of the offering, if any, to be made by selling security holders, the anticipated time of the offering and a brief statement of the manner and purpose of the offering without naming the underwriters;

(3) In the case of a rights offering to security holders of the issuer, the class of securities the holders of which will be entitled to subscribe to the securities proposed to be offered, the subscription ratio, the proposed record date, the approximate date upon which the rights are proposed to be issued, the proposed term or expiration date of the rights and the approximate subscription price, or any of the foregoing;

(4) In the case of an offering of securities in exchange for other securities of the issuer or of another issuer, the name of the issuer and the title of the securities to be surrendered in exchange for the securities to be offered, the basis upon which the exchange may be made, or any of the foregoing;

(5) In the case of an offering to employees of the issuer or to employees of any affiliate of the issuer, the name of the employer and class or classes of employees to whom the securities are proposed to be offered, the offering price or basis of the offering and the period during which the offering is to be made, or any of the foregoing; and

(6) Any statement or legend required by State law or administrative authority.

(b) Any notice contemplated by this rule may take the form of a news release or a written communication directed to security holders or employees, as the case may be, or other published statement.

Rule 137. Definition of "offers", "participates", or "participation" in Section 2(11) in relation to certain publications by persons independent of participants in a distribution.

The terms "offers", "participates", or "participation" in Section 2(11) shall not be deemed to apply to the publication or distribution of information, opinions or recommendations with respect to the securities of an issuer which is required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 and has filed or proposes to file a registration statement under the Securities Act of 1933 if--

(a) such information, opinions and recommendations are published and distributed in the regular course of its business by a dealer which is not and does not propose to be a member of the underwriting syndicate or dealer group in connection with the distribution of the security to which the registration statement relates; and

(b) such dealer receives no consideration, directly or indirectly, in connection with the publication and distribution of such information, opinions or recommendations from the issuer, a selling security holder or any member of the underwriting syndicate or dealer group or any other person interested in the securities to which the registration statement relates, and such information, opinions or recommendations are not published or distributed pursuant to any arrangement or understanding, direct or indirect, with such issuer, underwriter, dealer or selling security holder; provided, however, that nothing herein shall forbid payment of the regular subscription or purchase price of the document or other written communication in which such information, opinions or recommendations appear.

Rule 138. Definition of "offer for sale" and "offer to sell" in Sections 2(10) and 5(c) in relation to certain publications.

(a) Where an issuer which meets all of the conditions for the use of Form S-7 or S-9 has filed or proposes to file a registration statement under the Act relating solely to a non-convertible debt security or to a non-convertible, non-participating preferred stock, publication or distribution in the regular course of its business by a dealer of information, opinions or recommendations relating solely to common stock or to debt or preferred stock convertible into common stock of such issuer shall not be deemed to constitute an offer for sale or offer to sell the security to which such registration statement relates for purposes of Sections 2(10) and 5(c) of the Act, even though such dealer is or will be a member of the underwriting syndicate or dealer group in connection with the distribution of the security to which such registration statement relates.

(b) Where an issuer which meets all of the conditions for the use of Form S-7 has filed or proposes to file a registration statement under the Act relating solely to common stock or to debt or preferred stock convertible into common stock, the publication or distribution in the regular course of its business by a dealer of information, opinions or recommendations relating solely to a non-convertible debt security, or to a non-convertible, non-participating preferred stock, shall not be deemed to constitute an offer for sale or offer to sell the security to which such registration statement relates for purposes of Sections 2(10) and 5(c) of the Act, even though such dealer is or will be a member of the underwriting syndicate or dealer group in connection with the distribution of the security to which such registration statement relates.

Rule 139. Definition of "offer for sale" and "offer to sell" in Sections 2(10) and 5(c) in relation to certain publications.

Where an issuer which is required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 has filed or proposes to file a registration statement under the Securities Act of 1933 relating to

its securities, the publication or distribution by a dealer, in the regular course of its business, of information, an opinion or a recommendation with respect to the securities so registered or proposed to be registered shall not be deemed to constitute an offer for sale or offer to sell such securities for the purposes of Section 2(10) and 5(c) of the Act, even though such dealer is or will be a member of the underwriting syndicate or dealer group in connection with the distribution of such securities if all of the following conditions exist:

(a) such information, opinion or recommendation is contained in a publication which has for at least the past 2 years been distributed with reasonable regularity on an annual or other more frequent basis and each issue of which contains a comprehensive list of securities currently recommended by such dealer;

(b) such information, opinion or recommendation is given no greater space or prominence in such publication than that given to other securities, and does not include projections of sales or earnings beyond the issuer's current fiscal year or following fiscal year if within the last six months of the current fiscal year; and

(c) an opinion or recommendation at least as favorable as to the security was published by the dealer in either the last publication of the same character or in a subsequent publication of a different character, which was previously distributed by such dealer.

Rule 174. Delivery of Prospectus by Dealers; Exemptions under Section 4(3) of the Act.

The obligations of a dealer (including an underwriter no longer acting as an underwriter in respect of the security involved in such transactions) to deliver a prospectus in transactions in a security as to which a registration statement has been filed taking place prior to the expiration of the 40 or 90 day period specified in Section 4(3) of the Act after the effective date of such registration statement or prior to the expiration of such period after the first date upon which the security was bona fide offered to the public by the issuer or by or through an underwriter after such effective date, whichever is later, shall be subject to the following provisions:

(a) No prospectus need be delivered if the registration statement is on Form S-12 or S-13 unless registration of the deposited security is also required.

(b) No prospectus need be delivered if the issuer is subject, immediately prior to the time of filing the registration statement, to the reporting requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934.

(c) Where a registration statement relates to offerings to be made from time to time no prospectus need be delivered after the expiration of

the initial prospectus delivery period specified in Section 4(3) of the Act following the first bona fide offering of securities under such registration statement.

(d) Notwithstanding the foregoing, the period during which a prospectus must be delivered by a dealer shall be:

(1) As specified in Section 4(3) of the Act if the registration statement was the subject of a stop order issued under Section 8 of the Act; or

(2) As the Commission may provide upon application or on its own motion in a particular case.

(e) Nothing in this rule shall affect the obligation to deliver a prospectus pursuant to the provisions of Section 5 of the Act by a dealer who is acting as an underwriter with respect to the securities involved or who is engaged in a transaction as to securities constituting the whole or a part of an unsold allotment to or subscription by such dealer as a participant in the distribution of such securities by the issuer or by or through an underwriter.

Rule 15c2-8. Delivery of Prospectus.

(a) It shall constitute a deceptive act or practice, as those terms are used in Section 15(c)(2) of the Act, for a broker or dealer to participate in a distribution of securities with respect to which a registration statement has been filed under the Securities Act of 1933 unless he complies with the requirements set forth in paragraphs (b) through (g) below. For the purposes of this rule a broker or dealer participating in the distribution shall mean any underwriter and any member or proposed member of the selling group.

(b) Such broker or dealer shall take reasonable steps to furnish to any person who makes written request for a preliminary prospectus between the filing date and a reasonable time prior to the effective date of the registration statement to which such prospectus relates, a copy of the latest preliminary prospectus on file with the Commission. Reasonable steps shall include receiving an undertaking by the managing underwriter or underwriters to mail such copy to the address given in the requests.

(c) Such broker or dealer shall take reasonable steps to comply promptly with the written request of any person for a copy of the final prospectus relating to such securities during the period between the effective date of the registration statement and the later of either the termination of such distribution, or the expiration of the applicable 40 or 90 day period under Section 4(3) of the Securities Act of 1933. Reasonable steps shall include receiving an undertaking by the managing underwriter or underwriters to mail such copy to the address given in the requests. (The 40-day period referred to above shall be deemed to apply for purposes of this rule irrespective of the provisions of paragraph (b) of Rule 174 under the Securities Act of 1933).

(d) Such broker or dealer shall take reasonable steps (i) to make available a copy of the preliminary prospectus relating to such securities to each of his associated persons who is expected, prior to the effective date, to solicit customers' orders for such securities before the making of any such solicitation by such associated persons and (ii) to make available to each such associated person a copy of any amended preliminary prospectus promptly after the filing thereof.

(e) Such broker or dealer shall take reasonable steps to make available a copy of the final prospectus relating to such securities to each of his associated persons who is expected, after the effective date, to solicit customers orders for such securities prior to the making of any such solicitation by such associated persons, unless a preliminary prospectus which is substantially the same as the final prospectus except for matters relating to the price of the stock has been so made available.

(f) If the broker or dealer is a managing underwriter of such distribution, he shall take reasonable steps to see to it that all other brokers or dealers participating in such distribution are promptly furnished with sufficient copies, as requested by them, of each preliminary prospectus, each amended preliminary prospectus and the final prospectus to enable them to comply with paragraphs (b), (c), (d) and (e) above.

(g) If the broker or dealer is a managing underwriter of such distribution, he shall take reasonable steps to see that any broker or dealer participating in the distribution or trading in the registered security is furnished reasonable quantities of the final prospectus relating to such securities, as requested by him, in order to enable him to comply with the prospectus delivery requirements of Section 5(b)(1) and (2) of the Securities Act of 1933.

(h) This rule shall not require the furnishing of prospectuses in any state where such furnishing would be unlawful under the laws of such state; provided, however, that this provision is not to be construed to relieve a broker or dealer from complying with the requirements of Section 5(b)(1) and (2) of the Securities Act of 1933. Prospectuses shall not be furnished pursuant to this rule while the registration statement is subject to an examination, proceeding, or stop order pursuant to Section 8 of the Securities Act of 1933.

* * * *

The foregoing action was taken pursuant to the Securities Act of 1933, particularly Sections 4 and 19(a) thereof, and the Securities Exchange Act of 1934, particularly Sections 15(c)(2) and 23(a) thereof. Such action shall become effective November 19, 1970, except that Rule 15c2-8 shall be effective with respect to registration statements under the Securities Act of 1933 which become effective after December 31, 1970.

By the Commission.

Orval L. DuBois
Secretary

For RELEASE Monday, June 29, 1970

SECURITIES AND EXCHANGE COMMISSION
Washington, D. C.

Securities Act of 1933
Release No. 5071

The Securities and Exchange Commission today expressed its concern that the practice employed in some public offerings registered under the Securities Act of 1933, in which securities are reserved out of the public offering for employees or other designees of the registrant, be carried out in compliance with the requirements of Section 5(a) of the Act. Section 5(a) provides that no "sale" of securities may take place unless a registration statement is in effect as to such securities.

In Securities Act Release No. 4697 (1964), the Commission noted that during the period between the filing of a registration statement and its effectiveness, "no contracts of sale can be made...the purchase price may not be paid or received and offers to buy may be cancelled." The Commission there pointed out that "[i]t is a principal purpose of the so-called 'waiting period' between the filing date and the effective date to enable dealers and, through them, investors to become acquainted with the information contained in the registration statement and to arrive at an unhurried decision concerning the merits of the securities."

These requirements apply to the offer and sale of securities reserved for employees or other designees of management as well as to the rest of the registered offering. The purchase price may not be paid, directly or indirectly, by such persons nor may any broker-dealer participating in the distribution receive any consideration from the prospective purchaser in advance of the effective date of the registration statement. It is, of course, proper for a broker-dealer, including the managing underwriter, to obtain indications of interest from persons within the class for whom securities are being reserved. It is desirable that such persons receive copies of the preliminary prospectus in order to help them determine whether they wish to purchase the securities after the registration statement becomes effective. ^{1/} During the period before effectiveness, broker-dealers should make such inquiries as may be necessary to determine whether persons indicating an interest in purchasing reserved shares have sufficient credit and resources to warrant the opening of an account. Broker-dealers may seek to protect themselves from having to deal with persons who may be unable to comply with payment requirements by suitable provisions in their agreements or understandings

^{1/} See Securities Act Release No. 4968 (April 24, 1969).

with the issuer. It is improper, however, for any broker-dealer to insist on any form of pre-payment from the prospective purchaser, by way of deposit or otherwise, for the securities being offered.

The Securities Act contemplates that an independent affirmative investment commitment must be made by each purchaser of shares publicly offered and registered with the Commission after the registration statement has become effective and a definitive prospectus setting forth material information about the registrant and the securities offered is available. This purpose is thwarted by arrangements under which monies are deposited by purchasers in advance of effectiveness, and the burden is thereby placed on such persons to secure a return of their funds. Where such funds are not segregated, they may even become unavailable after effectiveness. Even where the funds are separately escrowed, the significance of independent investment decision making would inevitably be diminished.

The following examples are set forth for information only and are not intended to indicate the only practices which the Commission considers improper under the Securities Act.

Example 1

A registration statement was filed with respect to a proposed public offering of 200,000 shares of common stock, out of which 30,000 shares were to be reserved for employees and designees of the registrant, as disclosed in the prospectus. Prior to the effective date of the registration statement, the managing underwriter sent letters to approximately 120 such persons asking for a deposit of \$10 per share up to \$1,000 to be applied against the purchase price of any reserved shares they wished to purchase. These deposits were characterized as refundable upon demand. More than 100 employees indicated their interest in the offering and paid \$70,000 to the managing underwriter before the effective date. Although the managing underwriter claimed that the deposits were a necessary substitute for personal investigation of the new account holders under the know-your-customer rule of the New York Stock Exchange, the Commission's staff took the position that the practice constituted pre-selling of the reserved shares prior to effectiveness and was thus not in compliance with Section 5(a) of the Securities Act. The deposited funds were returned to the designees prior to the registration statement becoming effective. The designees were given a subsequent opportunity to purchase securities after the effective date of the registration statement and upon receipt of the final prospectus.

Example 2

A registration statement was filed with respect to a proposed public offering of 425,000 shares of common stock, out of which 30,000 shares were to be reserved for employees of the registrant, as disclosed in

the prospectus. Prior to the effective date of the registration statement, the managing underwriter asked those for whom shares were being reserved to deposit the approximate purchase price with a designated bank which acted as escrow agent. The employees also executed a power of attorney authorizing two officers of the issuer to determine whether, on the basis of the final prospectus, the reserved shares should be purchased by the employees or whether the monies deposited should be refunded. The Commission's staff took the position that this arrangement provided for advance payment of the purchase price prior to effectiveness and was, therefore, not in compliance with Section 5(a) of the Securities Act. The deposited funds were returned to the employees as in Example 1.

By the Commission.

Orval L. DuBois
Secretary

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
OFFICIAL BUSINESS
RETURN AFTER FIVE DAYS



For RELEASE Monday, June 29, 1970

SECURITIES AND EXCHANGE COMMISSION
Washington, D. C.

Securities Act of 1933
Release No. 5071

The Securities and Exchange Commission today expressed its concern that the practice employed in some public offerings registered under the Securities Act of 1933, in which securities are reserved out of the public offering for employees or other designees of the registrant, be carried out in compliance with the requirements of Section 5(a) of the Act. Section 5(a) provides that no "sale" of securities may take place unless a registration statement is in effect as to such securities.

In Securities Act Release No. 4697 (1964), the Commission noted that during the period between the filing of a registration statement and its effectiveness, "no contracts of sale can be made...the purchase price may not be paid or received and offers to buy may be cancelled." The Commission there pointed out that "[i]t is a principal purpose of the so-called 'waiting period' between the filing date and the effective date to enable dealers and, through them, investors to become acquainted with the information contained in the registration statement and to arrive at an unhurried decision concerning the merits of the securities."

These requirements apply to the offer and sale of securities reserved for employees or other designees of management as well as to the rest of the registered offering. The purchase price may not be paid, directly or indirectly, by such persons nor may any broker-dealer participating in the distribution receive any consideration from the prospective purchaser in advance of the effective date of the registration statement. It is, of course, proper for a broker-dealer, including the managing underwriter, to obtain indications of interest from persons within the class for whom securities are being reserved. It is desirable that such persons receive copies of the preliminary prospectus in order to help them determine whether they wish to purchase the securities after the registration statement becomes effective. ^{1/} During the period before effectiveness, broker-dealers should make such inquiries as may be necessary to determine whether persons indicating an interest in purchasing reserved shares have sufficient credit and resources to warrant the opening of an account. Broker-dealers may seek to protect themselves from having to deal with persons who may be unable to comply with payment requirements by suitable provisions in their agreements or understandings

^{1/} See Securities Act Release No. 4968 (April 24, 1969).

with the issuer. It is improper, however, for any broker-dealer to insist on any form of pre-payment from the prospective purchaser, by way of deposit or otherwise, for the securities being offered.

The Securities Act contemplates that an independent affirmative investment commitment must be made by each purchaser of shares publicly offered and registered with the Commission after the registration statement has become effective and a definitive prospectus setting forth material information about the registrant and the securities offered is available. This purpose is thwarted by arrangements under which monies are deposited by purchasers in advance of effectiveness, and the burden is thereby placed on such persons to secure a return of their funds. Where such funds are not segregated, they may even become unavailable after effectiveness. Even where the funds are separately escrowed, the significance of independent investment decision making would inevitably be diminished.

The following examples are set forth for information only and are not intended to indicate the only practices which the Commission considers improper under the Securities Act.

Example 1

A registration statement was filed with respect to a proposed public offering of 200,000 shares of common stock, out of which 30,000 shares were to be reserved for employees and designees of the registrant, as disclosed in the prospectus. Prior to the effective date of the registration statement, the managing underwriter sent letters to approximately 120 such persons asking for a deposit of \$10 per share up to \$1,000 to be applied against the purchase price of any reserved shares they wished to purchase. These deposits were characterized as refundable upon demand. More than 100 employees indicated their interest in the offering and paid \$70,000 to the managing underwriter before the effective date. Although the managing underwriter claimed that the deposits were a necessary substitute for personal investigation of the new account holders under the know-your-customer rule of the New York Stock Exchange, the Commission's staff took the position that the practice constituted pre-selling of the reserved shares prior to effectiveness and was thus not in compliance with Section 5(a) of the Securities Act. The deposited funds were returned to the designees prior to the registration statement becoming effective. The designees were given a subsequent opportunity to purchase securities after the effective date of the registration statement and upon receipt of the final prospectus.

Example 2

A registration statement was filed with respect to a proposed public offering of 425,000 shares of common stock, out of which 30,000 shares were to be reserved for employees of the registrant, as disclosed in

the prospectus. Prior to the effective date of the registration statement, the managing underwriter asked those for whom shares were being reserved to deposit the approximate purchase price with a designated bank which acted as escrow agent. The employees also executed a power of attorney authorizing two officers of the issuer to determine whether, on the basis of the final prospectus, the reserved shares should be purchased by the employees or whether the monies deposited should be refunded. The Commission's staff took the position that this arrangement provided for advance payment of the purchase price prior to effectiveness and was, therefore, not in compliance with Section 5(a) of the Securities Act. The deposited funds were returned to the employees as in Example 1.

By the Commission.

Orval L. DuBois
Secretary

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
OFFICIAL BUSINESS
RETURN AFTER FIVE DAYS

U.S. Securities and Exchange Commission
POSTAGE & FEES PAID



SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D. C.

SECURITIES ACT OF 1933
RELEASE NO. 5005

ADOPTION OF GUIDE RELATING TO MISLEADING CHARACTER
OF CERTAIN REGISTRANTS' NAMES

On April 7, 1969, the Commission published in Securities Act Release No. 4959 a proposed guide of the Division of Corporation Finance relating to the misleading character of the names of certain registrants and invited the views and comments of interested persons thereon. The comments received having been considered by the Division the text of the guide is set forth below in definitive form, unchanged from the language of the proposal.

54. Misleading Character of Certain Registrants' Names.

A registrant's name may be materially misleading if it indicates a line of business in which the registrant is not engaged or is engaged only to a limited extent. If the registrant is not engaged to any substantial extent in the business indicated by the name, a change of name may be the only way to cure its misleading character. If the registrant is substantially engaged in the line of business, even though it does not comprise the major portion of the business, it may be sufficient to disclose under the name of the registrant on the cover page of the prospectus the limited extent to which the registrant is engaged in the business indicated by its name. This paragraph does not apply, however, to an established company which over a period of years has changed the general character of its business and where the investing public is generally aware of the change and the character of the registrant's present business.

A registrant's name may also be misleading if it is the same or substantially the same as the name of another well-known company. If it appears likely that the registrant's name may be confused with the name of the other company, consideration should be given to changing the name. However, if both companies are new or small and relatively unknown and are located in different parts of the country, so that investors are not likely to mistake one company for the other, it would be sufficient to disclose on the cover page of the prospectus, under the name of the registrant, the lack of any relationship between the two companies.

* * * * *

By the Commission.

Orval L. DuBois
Secretary

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
OFFICIAL BUSINESS
RETURN AFTER FIVE DAYS

U.S. Securities and Exchange Commission
POSTAGE & FEES PAID



Objectives of the Investment Company Act

The Investment Company Act of 1940 is the compromise version of the Wagner-Lea bill which was introduced on March 14, 1940 as the Commission's proposed legislative remedy to the evils, abuses and malpractices disclosed in the Reports of the Commission's Study of Investment Trusts and Investment Companies. Although the Act is far less drastic than the original bill due to the substantial revision of many important provisions, the fundamental objectives of the original bill, to a certain extent, find expression in the Act.

The policy and purposes of the Investment Company Act, as set forth in Section 1(b) of the Act, are "to mitigate and, so far as is feasible, to eliminate" certain conditions, enumerated in that section, which adversely affect the public interest and interest of investors. 1/ These enumerated abuses, stated briefly, are:

1. Inadequate, inaccurate or unclear disclosure with respect to the investment company and its securities.
2. Self-dealing of insiders and of special interests.
3. Issuance of securities with inequitable terms; failure to protect the privileges and preferences of outstanding security holders.
4. Inequitable distribution or methods of control; irresponsible management.
5. Unsound or misleading accounting methods.
6. Reorganizations, changes in policy, or transfers of control without consent of security holders.
7. Excessive borrowing and excessive issuance of senior securities which unduly increase the speculative character of the junior securities.
8. Inadequate assets or reserves.

1/ It is interesting to note that practices similar to those which are here called adverse "conditions", are referred to in the Public Utility Holding Company Act as "abuses" and "evils" and in the Trust Indenture Act as "injurious" practices. Moreover, in those Acts, the legislative policy is stated to be the elimination of these practices without the limitation: "so far as is feasible". While the difference would seem to be purely rhetorical so far as it has a bearing on administration of the Acts, it serves to highlight the actual difference in the requirements of the Acts and the authority and duties given to the Commission under them.

The abuses listed in this section are couched for the most part in broad terms and would seem to be equally applicable to other types of financial enterprises, ordinary industrial corporations, or business trusts. In fact, it is probably not too conjectural to guess that, aside from certain abusive practices peculiar to investment companies, such as the "two-pricing system" of open-end companies, most of the abuses found in the investment trust field may be found in other fields as well. Their particular prevalence in the investment trust field was doubtlessly due in large measure to the comparative ease with which the liquid assets of the entirely unregulated investment trust could be misused and its accounts mishandled. This fact and the lack of governmental supervision and restrictions attracted brokers, investment bankers, securities salesmen and others who saw opportunities for ready personal profit to be derived from the cash-and-securities assets of investment companies. The extent to which the less scrupulous of these entrepreneurs, the so-called insiders, derived benefits for themselves to the detriment of security holders is disclosed in many specific case histories in the Investment Trust Study reports. The forms that some methods of profiting at the expense of investors assumed were too subtle and interrelated with other factors to be measured specifically. In some cases the possibilities of abuse could only be indicated. On the whole, however, the conclusion of the Commission's staff, adopted by the Congress (House Committee Report, 76th Congress, No. 2639, p. 7) to the effect that the tremendous losses of investors in investment companies were in substantial part due to selfish or unscrupulous mismanagement was overwhelmingly established.

On the basis of these facts it can be said that the fundamental purpose of the Investment Company Act in endeavoring to mitigate or eliminate the abuses named in Section 1(b) is to prevent the "insiders" or the "management" of investment companies from profiting directly or indirectly from investment companies to the detriment or at the expense of security holders to the end that investment companies will be operated exclusively in the interest of security holders. Supplementing this fundamental purpose, the Act attempts through regulations, prohibitions and requirements of disclosure to raise the standards of conduct of management, to provide for a greater degree of democracy for security holders and to achieve a sounder economic structure.

This basic purpose and supplemental aims are, in general, carried out by provisions which tend to:

1. Secure a more responsible management;
2. Prevent transactions with the investment company to the detriment of the company and its security holders;
3. Prevent discrimination among and inequitable treatment of security holders;
4. Prevent the formation of companies with unsound capital structures, prevent the issuance of securities with inequitable features and eliminate cross-ownership, circular ownership and pyramiding;

5. Assure proper disclosure of the affairs of the investment company and the character of its securities; and
6. Increase the voice of stockholders in management.

In addition to the foregoing the Act contains provisions directed against specific abuses which were present in periodic payment plans and face-amount companies.

It is intended in the following pages to summarize briefly the provisions of the Act as they fall within the categories mentioned above in order to indicate the interrelation of these provisions. (The provisions of the statute discussed herein apply only to registered investment companies.)

I. Responsibility of Management

In order to secure a more responsible management, the Act prohibits persons convicted within 10 years of a crime, or enjoined by a court, in connection with a security or financial fraud from participating in management (Sec. 9); provides for a certain amount of "independence" in the management (Sec. 10); prohibits directors from serving unless elected by security holders subject to certain limited exceptions and provides a method in the case of a common-law trust, where no election is required, by which a natural person may be removed from the office of trustee (Sec. 16); outlaws provisions in the organization instruments of investment companies that purport to exculpate the management for wilful misfeasance, bad faith, gross negligence or reckless disregard of duty (Sec. 17(h) and (i)); and makes embezzlement, with respect to the assets of an investment company a Federal crime. (Sec. 37)

The Act also endeavors to prevent irresponsible persons from organizing new investment companies by requiring a net worth of \$100,000 prior to a public offering of the securities of the company. (Sec. 14) 1/

An increase in responsibility on the part of management appears to be the broad purpose of those provisions of the Act which require that investment advisers, principal underwriters, and independent public accountants of investment companies must obtain the approval of the "independent" members of the board of directors and/or the security holders at certain periodic intervals. (Secs. 15 and 32)

1/ The capital requirements with respect to face-amount certificate companies contained in Sec. 28(a)(1) of the Act of \$50,000 for a company organized prior to March 15, 1940 and \$250,000 for a company organized after that date appear to be designed primarily to provide a cushion for face-amount certificates rather than to secure responsible management.

In the same connection, the Act contains provisions with respect to the custody of portfolio securities of a management company (Sec. 17(f)) and full custodianship or trusteeship in the case of a unit investment trust or periodic payment plan. (Secs. 26 and 27) The custody requirements are strengthened by provisions authorizing the Commission to require the bonding of officers and employees. (Sec. 17(g))

The Act also contains provisions authorizing the Commission to prescribe rules governing the nature and scope of the audit and the findings and opinions of the independent accountants; provisions subjecting officers, directors, investment advisers, affiliated persons of investment advisers, and 10% stockholders, to the same duties and liabilities imposed by Section 16 of the Securities Exchange Act of 1934; provisions requiring the controller or principal accounting officer or employee to be selected by security holders or by the board of directors. (Secs. 30 and 32)

The foregoing prohibitions, requirements and regulations are implemented by the authority granted to the Commission to bring injunction proceedings against the "management" for gross misconduct or gross abuse of trust. (Sec. 36) This authority may prove to be the strongest force for good in the statute, particularly if interpreted to cover a failure to act as well as the commission of a misdeed.

II. Transactions with Management

Perhaps the broadest of the regulatory provisions of the Act, designed to prevent abuses flowing from "self-dealing", are the provisions prohibiting affiliated persons and principal underwriters from selling property to or purchasing or borrowing property from an investment company. (Sec. 17(a)) 1/ The Commission is required to exempt a transaction prohibited by Section 17(a) by order upon application under Section 17(b) if the transaction meets the standards of fairness and of consistency with the policy of the investment company and the purposes of the Act. A measure of protection is thereby afforded the investment company and its security holders against "dumping", "unloading" and similar practices disclosed in the Investment Trust Study reports. The force of Section 17(a) depends considerably on the coverage of the definition of an "affiliated person" and the fact that the prohibition extends to an affiliated person of an affiliated person of an investment company.

The provisions against self-dealing are buttressed by a prohibition against upstream loans (Sec. 21); by a prohibition against purchases of securities underwritten by an affiliated underwriter during the existence of a selling syndicate (Sec. 10(f)); and limitations upon remuneration to affiliated agents and brokers. (Sec. 17(e))

The Commission is authorized to prescribe rules concerning joint or joint and several transactions with affiliated persons and principal underwriters. (Sec. 17(d)) The object of rules hereunder would be to prevent the recurrence of joint trading accounts and similar devices in which the major portion of the risk was borne by the investment company but the profits were divided on a less favorable basis for the company.

III. Inequitable Treatment of Security Holders

In connection with the distribution and redemption of securities, offers of exchange, plans of reorganization, transfers of control and shifts in the policy and operations of investment companies, management frequently for personal gain abused its inside position to the injury of security holders. The statute seeks to prevent to some extent unfair and inequitable treatment of security holders in connection with these activities. Provisions of the Act deal with, or delegate authority to deal with, the distribution and redemption of redeemable securities (Sections 12(b) and 22), the sale and repurchase of securities of closed-end companies (Section 23), offers of exchange of the securities of open-end companies, unit trusts and face-amount companies (Section 11), plans of reorganization (Section 25), the assignment of investment advisory and underwriting contracts (Section 15), and changes in the investment policy of investment companies (Sections 13 and 21).

1/ The sale or the rental of property in ordinary course of business is exempted from Section 17(a) by Section 17(c).

(a) Distribution and Redemption of Redeemable Securities

Section 22(a) in effect authorizes the National Association of Security Dealers to prescribe rules for its members concerning (1) the computation of the selling price or redemption value of redeemable securities in transactions between an investment company and a member of the N.A.S.D. and (2) the period of time which must elapse after sale before redemption. The stated purpose of this grant of authority is to eliminate or reduce so far as reasonably practicable dilution of the value of other outstanding securities or any other unfair result to holders of such securities. The problems in this connection arose mainly from the "two-price system" established by most open-end companies, in which there is a lag between the time of the establishment of a new price and the time the price becomes effective. ^{1/}

Rule 26 of the Rules of Fair Practice of the N.A.S.D. adopted under authority of Section 22 of the Act applies only to securities of open-end companies and, of course, only to members of the N.A.S.D.

Section 22(b) authorizes the N.A.S.D. to prohibit its members, in connection with a primary distribution, from purchasing any redeemable security from the issuer at any price other than the price at which such security is then offered to the public less a commission, discount or spread. This commission, discount or spread may be required to be computed with such method and within such limitations in order that the offering price does not include an unconscionable or grossly excessive sales load. The primary purposes for the authority granted in this subsection are the prevention of "riskless trading" and the charging of excessive sales loads. The practice of riskless trading, illustrated in the T.I.S. Management Corporation stop-order case, can probably also be dealt with by injunction proceedings under Section 36 for gross abuse of trust--at least in a case equally as vicious as the T.I.S. case. It may be noted that Section 22(b) refers only to the primary distribution of redeemable securities. It would seem, however, that riskless trading in connection with redemptions can be subjected to regulation under Section 22(a) since the problem is tied up with the dilution problem.

Section 22(c) authorizes the Commission, after one year from the effective date of the Act, to make rules and regulations covering the subject matter of Sections 22(a) and (b) and applicable to all underwriters of and dealers in the redeemable securities of any registered company.

In connection with the foregoing, it is to be noted that Section 12(b) authorizes the Commission to prescribe rules governing the distribution by an open-end company of its own securities otherwise than through an under-

^{1/} The basic difficulty results from the sale of securities at a price fixed prior to the sale thereof when in the meantime the value of the assets of the investment company has risen or fallen. The two-price system enabled greater advantage to be taken of the difference between price and asset value.

writer. Rules under Section 22(c) affecting underwriters and dealers can therefore be extended to open-end companies acting as distributors themselves. Section 10(d) companies, however, are excluded from Section 12(b). 1/

Section 22(d) prohibits the sale of redeemable securities by investment companies and their principal underwriters and by dealers except "at a current public offering price described in the prospectus". Excluded are sales pursuant to an offer of exchange, pursuant to an offer to security holders proportionate to their holdings and in accordance with Section 12(b) rules. This subsection has been interpreted to require a single offering price in order to prevent discrimination among purchasers, although it was also held not to prevent the charging of a lower sales load in the case of sales of securities in larger amounts. 2/

Suspension of redemption for more than seven days after tender of a redeemable security, with certain exceptions, is prohibited by Section 22(e). This, of course, does not give the company or its underwriter statutory leave to choose any one of the seven days to fix a redemption price after that date has passed and the new asset value is determinable. Such a practice contains all the elements of riskless trading and can undoubtedly be controlled under Sections 22(a) and 36.

Restrictions on the negotiability or transferability of open-end company securities are subject to such rules as the Commission may prescribe (Section 22(f)). As yet the Commission has not found it necessary to exercise this rule-making power. Most open-end companies do not restrict the transfer of their securities but several require that securities be held for a short time after purchase or that securities be offered to the company for purchase before they may be offered to third parties.

Open-end companies may not issue their securities for services, or for property other than cash or securities except as a dividend or in re-organization under Section 22(g). The same prohibition with respect to closed-end companies is contained in Section 23(a). The nature of the abuses against which these provisions are directed is obvious. It was not

1/ This exclusion seems odd in view of the fact that Section 10(d) companies are the only ones which were known to have acted as distributors of their own securities. However, in view of the restrictions placed on these companies, particularly the prohibition against charging a sales load and the incurring of sales or promotion expenses, the exclusion would not appear to be without reason.

2/ Opinion of General Counsel, March 13, 1941, Investment Company Act Release No. 89. Whether or not it be the real purpose, Section 22(d) prevents dealers from engaging in the practice of underpricing open-end securities by which they would obtain for themselves the market of principal underwriters of open-end companies. It is significant that Section 22(d) was not present in the original bill.

uncommon for investment companies to issue promotion or management stock to the organizers of the company for so-called services. There were also cases where real estate or other property of indefinite and illiquid value was exchanged for stock of the investment company. The prohibitions of these subsections do not cover securities, however, and to this extent there is latitude in the kind of consideration an investment company may receive for its securities.

(b) Distribution and Repurchase of Securities of Closed-end Companies

As indicated above, a closed-end company in general must receive cash or securities for the issuance of its securities. The price at which a closed-end company may sell its common stock is limited by Section 23(b) to not less than current net asset value, as determined therein, except under certain circumstances.

The provisions of Section 23(c) appear to be the result of a compromise on the various issues concerning the repurchase of securities by a closed-end company. Since practically all closed-end company securities have been selling at prices considerably below asset value, the security holder who sells his securities to his company at market value is giving up part of his interest in the net assets of the company in consideration of the immediate receipt of cash. On the other hand, if it were not for the market created by the issuer's purchases of its securities, the price obtained by a security holder would probably be considerably lower. As to the remaining security holders, such purchases are a benefit since they increase the net asset value per share of the outstanding securities but of course the assets of the company as a whole are decreased which may be disadvantageous to a small company.

The theory of Section 23(c) apparently is that disclosure and publicity of the policy and practice of the company in repurchasing securities will tend towards a fair price and an equal opportunity for all security holders to realize this fair price. Hence, the first paragraph of Section 23(c) permits purchases on a securities exchange (after disclosure of intention to buy in the case of stock within six months) and the second paragraph permits purchases pursuant to tenders after reasonable opportunity to all holders to submit tenders. The third paragraph authorizes the Commission by rule or order to permit purchases under other circumstances to insure that such purchases do not unfairly discriminate against any holders of the class or classes of securities to be purchased. Under the latter paragraph Rule N-23C-1 permits repurchases if various conditions or safeguards are present. This Rule is not intended to cover all permissible repurchases but creates standards which, if satisfied, do not require an immediate scrutiny of the repurchases.

(c) Offers of Exchange

Exchange offers of open-end companies made on any other basis than relative net asset values must receive the approval of the Commission or comply with rules of the Commission with respect thereto under Section 11. Exchange offers of securities of open-end companies for securities of unit investment trusts or face-amount companies, and exchange offers of securities of unit investment trusts and face-amount companies for the securities of any other investment company are subject to the Commission's authority

regardless of the basis of exchange. The practice of the promoters of open-end companies and fixed trusts in "switching" investors from one trust into another, charging a sales load each time, is an unsavory historical fact, the repetition of which Section 11 seeks to prevent.

Reorganizations and conversions are excepted from the restrictions of Section 11. Hence, companies like Group Securities, Inc. and New York Stocks, Inc. which issue securities in various classes, grouped according to industry, or type of security, and each class in effect a separate company, have provided that security holders may exchange securities of one class for another class upon payment of a conversion charge.

(d) Plans of Reorganization

The Commission was given a "negative power" with respect to reorganizations of investment companies rather than the duty to pass affirmatively upon plans of reorganization. Section 25(c) authorizes the Commission to bring proceedings on behalf of security holders of an investment company to enjoin any plan that is grossly unfair or that constitutes gross misconduct or gross abuse of trust on the part of the management. The definition of a "reorganization" is broad, enhancing the scope of authority of the Commission under Section 25.

Section 25(b) authorizes the Commission to render an advisory report concerning a plan of reorganization upon the request of an investment company or of 25% of any class of its security holders. The company is required to send a copy of such report to its security holders.

Section 25(a) concerns the filing of information concerning a plan of reorganization by a person soliciting proxies, etc. with respect to the plan, but in most instances such material would be obtained under the proxy rules (See Sec. 20).

(e) Assignment of Investment Advisory Contracts and Underwriting Contracts

The investment advisory or management contract and the underwriting contract frequently were devices for control of investment companies and sources of lucrative profits to the sponsoring group. These contracts were often indefinite in term and in the compensation to be paid and were sold without any notice to or approval of security holders.

Section 15 prevents the assignment of such contracts. It requires management contracts to be terminable upon 60 days' notice, approved in the first instance by a majority of the voting stockholders, and after two years, approved at least annually by the board of directors or stockholders. It requires underwriting contracts of open-end companies to be approved, after two years, at least annually by the board of directors or stockholders. In addition, management and underwriting contracts may not be entered into or renewed unless a majority of the board of directors not affiliated with the investment adviser or underwriter approves.

The underlying purpose of this section to outlaw shifts in management without the consent of the security holders and to prevent "management" from obtaining permanent control of an investment company to the exclusion of the desires of security holders is implicit in the context of the section. Whether the provisions in themselves are effective or have a merely psychological value remains to be seen. It appears, however, that the provisions derive added vitality by reason of an opinion of the General Counsel holding that the assignment of a management contract (which by definition in Section 2(a)(4) includes the sale of a controlling block of stock of the assignor) for a consideration through direct or indirect means was not only a violation of Section 15 but a breach of trust subject to Commission action under Section 36 of the Act. 1/

(f) Changes in Investment Policy

A serious condition revealed by the investigation of investment companies was the absence of any requirement on the part of "management" to adhere to stated policies. Stockholders were rarely consulted or even informed about the most radical changes in investment policy. Sections 12(c), 13 and 21(a) in combination with Sections 8(b), 5(a) and 5(b) were designed to remedy this condition.

Section 5(a) divides management companies into open-end and closed-end companies and Section 5(b) divides them into diversified and non-diversified companies. Section 13(a) requires a majority of the voting stock to consent to any change in the 5(a) subclassification and any change from a diversified to a non-diversified company.

Section 8(b) requires a recital of policy in a company's registration statement in respect of: (A) its classification as defined in Section 4 and 5, (B) borrowing money, (C) issuance of senior securities, (D) engaging in underwriting, (E) concentrating investments in an industry or group of industries, (F) purchase and sale of real estate or commodities, (G) making loans, and (H) portfolio turnover. Section 13(a) requires a majority vote before it may deviate from these recitals of policy, except with respect to portfolio turn-over and a change from a non-diversified to a diversified company. 2/ A majority vote is also required before a company may change the nature of its business so as to cease to be an investment company.

Section 12(c) prohibits a diversified company from making an underwriting commitment, if thereafter its outstanding underwriting commitments, plus the value of its investments in securities of issuers of which it owns more than 10% of the voting securities, exceeds 25%.

1/ Opinion of General Counsel, May 11, 1942, Investment Company Act Release No. 354.

2/ A non-diversified company that temporarily becomes diversified is granted an exemption, by Rule N-13A-1, from Section 13(a) with respect to a change back to a non-diversified status.

Section 21(b) makes it unlawful for a company to make loans not permitted by its recitals of policy.

It is clear that the effectiveness of the prohibitory sections (13 and 21) depend upon how definitive and precise the recitals of policy under Section 8(b) are set forth. "Management", of course, want to recite policies in as vague and indeterminate a manner as possible in order to avoid being "hampered" in managing the assets of the investment company. A vague recital not only renders regulation superficial but does not provide sufficient disclosure of a company's basic policies upon which a security holder may rely.

A recital of policy under Section 8(b) may be expressed in terms of policy, intention or freedom of action. If a company intends to engage in one of the activities enumerated in Section 8(b), it should define the limits and conditions of its intention to the extent practicable. Any reservation of freedom of action inconsistent with the actual intention of the company is meaningless. The policy of a company in large measure depends upon the nature of its business and operations, its history and experience and its objectives. 1/

1/ These points have been publicly announced in an opinion of the General Counsel, July 23, 1941, Investment Company Act Release No. 167.

IV. Unsound Structures and Securities

Among the devices contrived by management to serve its own special interests (for control or profit) regardless of detriment to the public investor were the creation of highly unsound corporate and intercorporate structures and the issuance of securities burdened with unfair and inequitable terms, conditions and provisos.

The Act tends to meet these problems by provisions covering excessive borrowing and top-heavy senior security structures (Sec. 18), cross and circular ownership (Sec. 20), pyramiding (Sec. 12), and requirements with respect to voting rights, touch-off clauses and dividend restrictions of new securities (Sec. 18). The right to issue warrants is limited (Sec. 18(d)) and voting trust agreements in connection with a public offering are prohibited (Sec. 20(b)).

Bearing some relation to these primarily economic matters, the Commission is authorized to make rules covering the purchase of securities on margin, participation in trading accounts and short sales (Sec. 12(a)).

Investment companies are given the right to make a limited investment in a "venture capital" corporation, notwithstanding any provision of the Act (Sec. 12(e)). The restrictions on pyramiding and related matters in Section 12(d) and the limitations placed on an investment company with respect to its investment policy by Sections 12(c), 13(a) and 21(a) might perhaps otherwise prevent such an investment.

V. Disclosure and Accounting Practices

Numerous provisions of the Act pertain to disclosure and accounting practices.

A detailed registration statement is provided for in Section 8(b), requiring in addition to the same information and documents required in order to register under the Securities Act and the Securities Exchange Act, a recital of the fundamental policies of the investment company, a list of affiliated persons and their other affiliations, and a statement of the business experience of each officer and director for the last five years.

Sections 30(a) and 30(b)(1) provide for annual and semi-annual or quarterly reports to be filed with the Commission to keep current the information and documents contained in the registration statement. Semi-annual reports to stockholders are required by Section 30(d). The power of suspension or revocation of registration is granted to the Commission in Section 8(e) for failure to comply with the disclosure provisions of Section 8 and Section 30 or, in connection therewith, for a violation of Section 34 which makes unlawful, false statements or misleading omissions in documents filed or transmitted pursuant to the Act. Suspension or revocation of registration is an effective remedy in view of the provisions of Section 7 concerning unregistered investment companies.

Section 24(d) renders the exemptions provided by Sections 3(a)(8) and 3(a)(11) of the Securities Act of 1933 unavailable for investment companies. Section 24(b) requires the sales literature of open-end companies, unit investment trusts and face-amount companies to be filed with the Commission within ten days after use.

Disclosure of the source of dividend payments is covered by Section 19.

The Commission is given considerable authority to make rules concerning financial statements (Sec. 30(e)), maintenance and preservation of books and records and uniform rules of accounting (Secs. 31 and 32(c)).

The Commission is given authority to make rules governing the solicitation of proxies. (Sec. 20) With respect to plans of reorganization, the Commission may render an advisory report to be sent to security holders but only if the investment company or 25% of any class of security holders requests such report (Sec. 25(b)).

In the case of unit investment trusts, notice of the substitution of any security in the unit must be required by the trust agreement of unit trusts whose securities are sold after the effective date of the Act (Sec. 26(a)(4)).

VI. Voice in Management

Directly or indirectly, various sections of the Act tend to increase democratization of investment companies. Provisions which accord some measure of voting rights to security holders are those concerning: shifts in investment policy (Sec. 13); management and underwriting contracts (Sec. 15); election of directors and removal of natural persons as trustee (Sec. 16); issuance of senior securities and common stock (Sec. 18); and selection of an independent accountant (Sec. 32). Provisions which indirectly aid in giving security holders a voice in management are those which restrict devices for control, such as voting trusts (Sec. 20(b)), pyramiding (Sec. 12), stock issued for services rendered (Secs. 22(g) and 23(a)), cross and circular ownership (Sec. 20(c) and (d)) and senior securities (Sec. 18).

VII. Periodic Payment Plans and Face-Amount Certificate Companies

Specific provisions designed to remedy abuses and malpractices peculiar to periodic payment plans and face-amount certificate companies are set forth in the Act.

Sections 12(f), 18(j), 24(c), 28 and 29 apply to face-amount certificate companies. Sections 24(c), 26 and 27 apply to periodic payment plans.

April, 1971

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

THE ORGANIZATION OF INVESTMENT COMPANIES
and
THE INVESTMENT COMPANY ACT OF 1940

The attached memorandum has been prepared by the Division of Corporate Regulation to assist persons interested in organizing an investment company or an investment club. The memorandum discusses the applicability of the Investment Company Act of 1940 to such organizations and questions frequently raised in complying with its requirements.

All persons who may have further questions concerning these matters are encouraged to write to the Division of Corporate Regulation, Securities and Exchange Commission, Washington, D.C. 20549.

THE ORGANIZATION OF INVESTMENT COMPANIES
and
THE INVESTMENT COMPANY ACT OF 1940

Investment Companies Subject to the Act

Investment companies are defined in Section 3(a) of the Investment Company Act of 1940. The definition is in the alternative on a qualitative and quantitative basis. Thus, it covers (1) an issuer of securities which is engaged or proposes to engage in investing, reinvesting or trading in securities or (2) an issuer which owns or proposes to acquire investment securities valued at more than 40% of its total assets. Face-amount certificate companies, a particular type of investment company, are also included in the definition.

A number of exceptions to the definition are contained in Section 3(b) and (c) of the Act. Of particular note is the exception of Section 3(c)(1) for an issuer whose securities are beneficially owned by not more than 100 persons and which is not making or does not presently propose to make a public offering of its securities.

In addition to the exceptions set forth in Section 3, various exemptions from the Act are provided for in Section 6. Of perhaps greatest interest are the exemptions to the extent permitted by the Commission, for an employees' securities company and for a small intrastate, closed-end investment company not intending to have more than \$100,000 of assets.

Investment companies offering their shares for sale to the public must file a registration statement for their securities under the Securities Act of 1933 as well as register the company under the Investment Company Act of 1940. Even if the public offering is entirely intrastate the registration requirements of the Securities Act must be complied with because the intrastate exemption contained in Section 3(a)(11) of that Act is made inapplicable by Section 24(d) of the Investment Company Act to any security of a registered investment company. The question of whether a public offering is involved is the same as under the Securities Act of 1933. The question most frequently arises in connection with the formation of "investment clubs" and is discussed below.

Investment Clubs

The Investment Company Act of 1940 and the Securities Act of 1933 are pertinent to the organization of investment clubs. Membership in a club usually involves a mutual agreement among the members pursuant to which payments are made to the club to be used for investment purposes

and members are entitled to share pro rata in the profits or losses of the club and, upon withdrawal, in its assets. Whether or not such membership is evidenced in writing, it would appear to be an "investment contract" and, as such, a security as defined in the Investment Company Act and the Securities Act.

The club, which is the issuer of this security (membership), falls within the definition of an investment company contained in the Investment Company Act, where the club engages, or proposes to engage, primarily in investing or trading in securities. The club, therefore, unless otherwise excepted or exempt from the provisions of the Investment Company Act, must register thereunder. Such a club, however, would be excepted from the definition of an investment company if it is not making and does not presently propose to make a public offering of its securities, that is, memberships in the club, and where the number of memberships is limited as provided in Section 3(c)(1).

This same question of whether the club is making or proposes to make a public offering of its membership is determinative of whether such membership, as a security, is required to be registered under the provisions of the Securities Act of 1933, or is not so required by reason of the exemption contained in Section 4(2) with respect to transactions by an issuer not involving any public offering. The exemptions from registration under that Act for an intrastate offering pursuant to Section 3(a)(11) or for an offering of less than \$300,000 under Regulation A are not available to registered investment companies.

The question as to whether an investment club is making or proposes to make a public offering of its memberships in a particular case would depend upon all the facts of the case, including the particular methods used to contact and get members. Any general solicitation for membership either through the mails, by newspaper publication, or otherwise, might constitute a public offering. Likewise, the personal solicitation of individuals for membership, if such solicitation covered more than a very limited group, irrespective of how many such individuals actually became members, might well constitute a public offering. Certain criteria to be considered in connection with the problem are laid down in Securities Act Release No. 4552 (1962). In addition to this release there are several decided cases on the subject including the Supreme Court decision of Ralston Purina v. S.E.C. 346 U. S. 119 (1953).

If a public offering of a club's membership is contemplated, registration under the Investment Company Act and the Securities Act would be required.

Registration of Investment Companies

An investment company registers under the Investment Company Act by filing a Notification of Registration with the Securities and

Exchange Commission on Form N-8A. Thereafter a more detailed registration statement must be filed. Form N-8B-1 is prescribed for management investment companies and Form N-8B-2 for unit investment trusts, including trusts which are the issuers of periodic payment plan certificates. Registration under the Securities Act is accomplished by closed-end management investment companies on Form S-4; by open-end management companies on Form S-5, and by unit investment trusts on Form S-6.

Reports of Investment Companies

After registration the investment company will be required to file with the Commission certain reports, documents and information. Of importance are the following:

1. Annual reports designed to bring up to date the information contained in the registration statement.
2. Quarterly reports, but only if certain specified events have taken place, such as changes in policy, changes in securities and other items.
3. Copies of all reports to security holders which contain financial statements.

It is to be noted that investment companies are subject to the Commission's rules regarding the solicitation of proxies, consents or authorizations and must comply with the filing and other requirements of these rules.

Where the company does not maintain its assets under a full custodianship agreement with a bank, it must maintain its assets either in the custody of a member of a national securities exchange or under a safekeeping arrangement with a bank subject to the Commission's rules. Certificates of independent public accountants called for under these rules must be transmitted to the Commission promptly after each examination.

Pursuant to Commission rules, officers and employees of investment companies who have access to the assets of the company or authority to direct the disposition of such securities must be bonded by a fidelity insurance company. A corporate resolution concerning such bond and a copy of the bond, including renewals, must be filed with the Commission.

In the case of an open-end company, a unit trust or face-amount company, copies of all sales literature must be filed with the Commission.

If the company is a closed-end company, reports of beneficial ownership of, and transactions in, the securities of the company must be filed by directors, officers, investment advisers, affiliates of investment advisers and 10% stockholders. Forms for such ownership reports have been prescribed by the Commission.

In the event that a closed-end company repurchases its outstanding securities pursuant to Rule 23c-1, a report of its acquisitions must be filed on a form prescribed by the Commission. The Commission must also be given notice of any call or redemption of securities by a closed-end company.

Copies of the various forms prescribed may be obtained from the Commission upon request.

Initial Capital of \$100,000

Among the matters to be given consideration by the promoters of an investment company at the time of organization is the important mandate of Section 14(a) of the Investment Company Act requiring an initial \$100,000 before the company may do business.

Section 14(a) of the Investment Company Act provides, in substance, that no registered investment company or its principal underwriter shall make a public offering of that company's securities unless (1) the company has a net worth of \$100,000, or (2) the company made a previous offering of securities at which time it had a net worth of \$100,000, or (3) adequate provision is made as a condition of the registration of the company's securities under the Securities Act of 1933 so that the company insures the following:

(A) After the effective date of the Securities Act registration statement, the company will not issue any security or receive proceeds of any subscription for any security until firm agreements have been made with not more than 25 persons to purchase from the company securities to be issued by it for an aggregate net amount which, plus the then net worth of the company, will equal \$100,000.

(B) The said aggregate net amount will be paid in to such company before any subscriptions for the company's securities will be accepted from more than 25 persons.

(C) Arrangements will be made so that proceeds paid in by any subscriber, as well as the sales load thereon, will be refunded to him on demand in full, if the net proceeds received by the company do not bring the company's net worth to at least \$100,000 within 90 days

after the registration statement becomes effective. The Commission may suspend the effectiveness of the Securities Act registration statement and revoke the Investment Company Act registration if the company's net worth is not at least \$100,000 90 days after the Securities Act registration statement becomes effective.

If a company can qualify under Subsections 14(a)(1) or 14(a)(2) of the Investment Company Act, it can proceed with a public offering of its securities after it has registered under the Investment Company Act and its registration statement under the Securities Act of 1933 has become effective. If, however, a company cannot so qualify, it must comply with the requirements of Section 14(a)(3). Section 14(a)(3) does not limit the solicitation of prospective subscribers, but allows a public offering to be made to more than 25 persons before the initial \$100,000 is raised, if the prescribed procedure is followed and the required assurances made to the Commission's satisfaction.

Under Section 14(a)(3), however, the company or its underwriter must not issue securities or receive proceeds of subscriptions for such securities from anybody until it has firm agreements from 25 or less persons to purchase the company's securities in a net amount, which, when added to whatever other net assets it has, will equal \$100,000 in value.

Once the \$100,000 worth of commitments from 25 or less persons is secured, the company may issue the securities to these 25 persons and receive payment therefor. Under the Investment Company Act these payments must be received before the company may accept subscriptions from any other prospective purchasers whom it may have solicited in excess of 25, but, as noted, there is no restriction on the number of persons to whom an offering may be made before the payments from the 25 are received, so long as the subscriptions are not accepted before the \$100,000 is paid in. The time limit on this procedure is ninety days from the effective date of the Securities Act registration statement, and the company must make arrangements so that, if it cannot bring its net worth to \$100,000 from the amounts paid in by the 25 or less persons whose subscriptions have been obtained through the procedure outlined above within this 90-day period, it will return the full price paid in to any subscribers on demand without deduction.

Even when the shares of a new investment company are the subject of a single public offering greatly in excess of \$100,000 through an underwriter, an undertaking must be filed with the Commission assuring compliance with Section 14(a)(3).

The Commission has interpreted Section 14(a) to mean that the issuer must have a bona fide net worth of \$100,000, and such sums cannot be loaned or advanced as a temporary accommodation by those persons who

subscribe therefor, nor can there be any intention, when the investment is made, to redeem or dispose of such investment. The issuer should, in order to avoid any doubt about the question secure assurances from the subscribers of the initial \$100,000 to the effect that those subscribers are buying for investment purposes, and not with the present intention of redeeming or reselling the stock when additional funds are provided from public sale of the stock. The registrant is requested to inform the Commission in detail as to the manner in which Section 14(a)(3) was complied with. It is expected that the Commission will be advised that stockholders who furnished the initial \$100,000 were notified of the requirement that they purchase for investment and that their purposes in holding registrant's stock are consistent with such intention.

The registrant is also requested to inform the Commission whether, apart from agreements already disclosed in the registration statements filed with the Commission, there are any agreements or understandings regarding the registrant or its securities between or among registrant, the investment adviser, the principal underwriter, promoters and the initial stockholders which are made, directly or indirectly, in consideration of the purchase of the initial \$100,000 of stock. Such agreements or understandings may be inconsistent with the policy and provisions of Section 14(a)(3).

If the initial raising of the minimum \$100,000 is made through a public offering at a reduced sales load or with no sales load at net asset value, the provisions of Section 22(d) require that this offering price be described in the prospectus and be the same for all subscribers solicited during that period - not only the group of twenty-five persons or less referred to in Section 14(a)(3).

The promoters of an investment company may obtain the initial \$100,000 through a private offering even though a public offering is at that time contemplated. The initial subscriptions or commitments would have to be limited to a small predetermined group of organizers and associates intending to acquire the new securities for investment. If the transactions are in fact private, these initial sales will not be regarded as integrated with the subsequent public offering. Moreover, no question will be raised if these initial sales or firm commitments are at net asset value or at net asset value plus a lower sales load than that to be charged in connection with the public offering, provided full disclosure of the transactions is contained in the prospectus. As noted above, when the public offering is made the offering price must, of course, be the same for all persons in accordance with the requirements of Section 22(d) of the Act, subject to the usual exceptions thereto.

In the case of an initial private raising of funds from the organizers and their associates, registration under the Investment Company Act may precede or follow the private offering. However, the preliminary private transactions should precede the effective date of the registration statement under the Securities Act.

For RELEASE Tuesday, October 21, 1969

SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549

INVESTMENT COMPANY ACT OF 1940
Release No. 5847
ACCOUNTING SERIES
Release No. 113

The Securities and Exchange Commission today made public the following statement.

"Restricted Securities"

The Commission is aware that many investment companies have been acquiring substantial quantities of securities that cannot be offered to the public for sale without first being registered under the Securities Act of 1933 ("restricted securities"). For the year 1968, annual reports filed by registered investment companies indicate that open-end and closed-end companies together held in excess of \$4.2 billion of restricted equity securities. Open-end companies--excluding exchange funds--accounted for about \$3.2 billion of these restricted securities which represented 4.4 per cent of their total net assets. The acquisition by investment companies of such securities raises certain problems under the securities laws of which shareholders, distributors, managements and directors of these companies should be aware. This statement discusses these problems. No inference should be drawn from publication of this statement, however, as to the desirability or merits of the acquisition of restricted securities by a registered investment company.

Problems for the Seller

Section 4(2) of the Securities Act of 1933 exempts from the registration requirements of that Act "transactions by an issuer not involving any public offering." This is the so-called "private offering" provision in the Securities Act. The securities involved in transactions effected pursuant to this exemption are referred to as restricted securities because they cannot be resold to the public without prior registration. They are also sometimes referred to as "investment letter securities" because of the practice frequently followed by the seller in such a transaction, in order to substantiate the claim that the transaction does not involve a public offering, of requiring that the buyer furnish a so-called "investment letter" representing that the purchase is for investment and not for resale to the general public.

The private offering exemption of Section 4(2) of the Securities Act is available only where the offerees do not need the protections afforded by the registration procedure. As the Court of Appeals for the Second Circuit recently stated in Katz v. Amos Treat & Co. CCH Fed'l. Sec. Law Rep. ¶ 92,409 (1969):

"The Supreme Court has instructed that the applicability of the exemption should turn on whether the particular class of persons affected need the protection of the Act. SEC v. Ralston Purina Co., 346 U. S. 119, 125 (1953)."

The test of the availability of the Section 4(2) exemption is whether the offerees are in such a position with respect to the issuer as to have access to the kind of information that would be made available in a registration statement filed pursuant to the Securities Act. This test is no different when the offeree is an investment company.

Problems for the Buyer

1. The Problems of Valuation

It is critically important that an investment company properly value its portfolio securities. It is obvious, for example, that any distortion in the valuation of a restricted security held by an investment company will distort the price at which the shares of the investment company are sold or redeemed. It is also clear that investment managers who are compensated on the basis of net asset value or performance may be unduly compensated if a restricted security, purchased at a discount from the market quotation for unrestricted securities of the same class, is overvalued. In such a case, investors may also be misled by the reported performance of the investment company.

The acquisition of restricted securities by both open-end and closed-end investment companies creates serious problems of valuation. Section 2(a)(39) of the Investment Company Act of 1940 and Rule 2a-4 thereunder requires that in determining net asset value, "securities for which market quotations are readily available" must be valued at current market value while other securities and assets must be valued at "fair value as determined in good faith by the board of directors."

Readily available market quotations refers to reports of current public quotations for securities similar in all respects to the securities in question. No such current public quotations can exist in the case of restricted securities. For valuation purposes, therefore, restricted securities constitute securities for which market quotations are not readily available. Accordingly, their fair values must be determined in good faith by the board of directors and this obligation necessarily continues throughout the period these securities are retained in the company's portfolio.

Restricted securities should be included in the portfolio of a company and valued to determine current net asset value on the date that the investment company has an enforceable right to demand the securities from the seller.

Where the investment company negotiates the acquisition of the restricted securities directly with the owner of the securities, there are three significant dates. The first occurs when the investment company and the seller orally agree upon the price and the amount of the securities (the "handshake date"). At this point, there would not seem to be any enforceable right of the investment company to demand the securities from the seller since, in most states, particularly those which have adopted the Uniform Commercial Code, there is no enforceable right unless there exists some writing "sufficient to indicate that a contract has been made for sale of a stated quantity of described securities at a defined or stated price" (Section 8-319(a) of the Uniform Commercial Code). If the terms of the oral understanding do not contemplate compliance with any condition by the seller, it is suggested that the investment company procure, from the seller, a signed memorandum setting forth the price and quantity of securities to be sold. Upon receipt of that memorandum, an enforceable right would be obtained. The securities should be valued as of that date.

In those situations where the oral understanding contemplates the execution of a formal contract of purchase and sale, no enforceable right exists until the time the formal contract is signed (the "contract date"). If the formal contract does not require compliance with any conditions by the seller, an enforceable right is then obtained, and the securities should be valued as of that date.

Where the formal contract requires compliance with stated conditions which the investment company believes should not be waived, no enforceable right is obtained until the stated conditions are satisfied. In that situation, the valuation date should be the date upon which the conditions are satisfied (the "closing date").

Restricted securities are often purchased at a discount, frequently substantial, from the market price of outstanding unrestricted securities of the same class. This reflects the fact that securities which cannot be readily sold in the public market place are less valuable than securities which can be sold, and also the fact that, by the direct sale of restricted securities, sellers avoid the expense, time and public disclosure which registration entails.

As a general principle, the current fair value of restricted securities would appear to be the amount which the owner might reasonably expect to receive for them upon their current sale. This depends upon their inherent worth, without regard to the restrictive feature, adjusted for any diminution in value resulting from the restrictive feature. Consequently, the valuation of restricted securities at the market quotations for unrestricted securities of the same class would, except for most unusual situations, be improper. ^{1/} Further, the continued valuation of such securities at cost would be improper if, as a result of the operations of the issuer, change in general market conditions or otherwise, cost has ceased to represent fair value. In such circumstances, maintaining the value of the restricted securities at cost would mislead investors as to the value of the portfolio of the investment company which holds restricted securities.

Instead of valuing restricted securities at cost or at the market value of unrestricted securities of the same class, some investment companies value restricted securities held in their portfolio by applying either a constant percentage or an absolute dollar discount to the market quotation for unrestricted securities of the same class. The automatic valuation of restricted securities by such a method, however, would also not appear to satisfy the requirement of the Act that each security, for which a market quotation is not readily available, be valued at fair value as determined in good faith by the board of directors.

Thus, it would be improper in valuing restricted securities automatically to maintain the same percentage discount (from the market quotation for unrestricted securities of the same class) that was received when the restricted securities were purchased, without regard to other relevant factors such as, for example, the extent to which the inherent value of the securities may have changed.

Furthermore, the valuation of restricted securities by reference to the market price for unrestricted securities of the same class assumes that the market price for unrestricted securities of the same class is representative of the fair value of the securities. This may not be the case when the market for the unrestricted securities is very thin, i.e., only a limited volume of shares are available for trading. With a thin market, the news of the investment company's purchase of the restricted securities may, by itself, have the effect of stimulating a public demand for the unrestricted securities, the supply of which has not been increased, and thus lead to a spiralling increase in the valuation of both the restricted and unrestricted securities.

^{1/} See Proposed Guidelines For The Preparation Of Form N-8B-1, Investment Company Act Release No. 5633, p. 21 (March 11, 1969).

Moreover, if in valuing restricted securities, the diminution in value attributable to the restrictive feature is itself affected by factors subject to change, such as the length of time which must elapse before the investment company may require the issuer to cause the securities to be registered for public sale, the valuation should reflect any such changes.

Some companies value restricted securities, acquired at prices below the market quotations for unrestricted securities of the same class, by automatically amortizing the difference over some chosen period on the assumption that it will be possible to sell them at the market price for unrestricted securities at the expiration of the time period. Under prevailing conditions, however, it cannot always be determined either that the securities will, in fact, be effectively registered at the expiration of that period or that their public sale will otherwise be possible. For example, the issuer may be unable or unwilling to register at the expiration of the estimated period, and public sale at the end of that period without registration may not be lawful. Consequently, the practice of automatically amortizing the discount over an arbitrarily chosen period creates the appearance of an appreciation in the value of the securities which has not, in fact, occurred, and, accordingly, is improper.

An undertaking by the issuer to register the securities within a specified time period would not dictate a different result. In view of the many factors that may alter the date of the proposed public offering, it is at best speculative to use such an undertaking alone as the basis for amortizing the discount.

Similarly, the possible adoption by the Commission of the more definite holding periods contained in proposed Rules 101, 160, 161, 162, 163, 164, and 180, Securities Act Release No. 4997, (dated September 15, 1969) would also not alter the conclusion that amortization of the discount may be improper. The more definite holding periods there proposed are available only if certain specified conditions are met.

In summary, there can be no automatic formula by which an investment company can value restricted securities in its portfolio to comply with Section 2(a)(39) and Rule 2a-4. It is the responsibility of the board of directors to determine the fair value of each issue of restricted securities in good faith; and the data and information considered and the analysis thereof should be retained for inspection by the company's independent auditors. While the board may, consistent with this responsibility, determine the method of valuing each issue of restricted security in the company's portfolio, it must continuously review the appropriateness of any method so determined. The actual calculations may be made by persons acting pursuant to the direction of the board.