

DIVISION OF CORPORATION FINANCE

TRAINING PROGRAM LECTURES

Seventh Session -- March 15, 1957

Subject: Techniques for the Processing
of Registration Statements

Speaker: Mr. Ralph Hocker, Branch Chief
Division of Corporation Finance

MR. HOCKER: At this stage I think we can make a few comments about the responsibilities and activities of the other members of the section team in examination of the registration statement. As previously mentioned the section accountant reviews registration statements with the primary responsibility for checking the financial statements, supporting schedules and any other financial information contained in the registration statement. In addition to that, he is responsible for an overall scrutiny of the registration statement, including any exhibits, with particular reference to whether information contained in the financial statements is correct financial data.

The section attorney also has the duty of overall scrutiny of the registration statement. He has certain very specific areas of responsibility such as to determine what securities should be registered; to ascertain that material facts and relationships essential for an intelligent judgment as to the security have been accurately disclosed in the prospectus; to determine whether exculpatory provisions which might include Securities Act liabilities are accurately disclosed; to determine the adequacy of the required opinion of counsel with respect to the securities offered; if the security is a debt obligation, to determine that the trust indenture contains the required provisions of, and otherwise conforms to, the Trust Indenture Act; to determine the adequacy of disclosure of regulatory acts and similar laws where appropriate; and to check the availability of the exemption claimed under Item 26 of Form S-1 for securities issued without registration in the past three years. If the statement of facts in support of the claims for exemption is inadequate, further information should be requested.

The analysts may have observed in processing registration statements that in many cases they have been able to get very little assistance from the attorneys in the section. That is clearly not a desirable situation and can only be excused on the basis of the pressure of other work assigned to the attorneys. Of course some cases do not require any specific attention by the section attorney where the issuers have made previous filings and their problems have previously been resolved.

Every analyst must have a working knowledge of the Securities Act and the field of corporate law as well as a working knowledge of accounting. If he does not have such knowledge, in the course of his work he must make every effort to acquire it.

To return to the analyst's job, the analyst after performing the review and examination previously described is ready to prepare his own report on the examination and to collect the memoranda from the other persons working on the registration statement for delivery to the section chief. There are several things that should be said about the preparation of the examiner's report.

First, it should set forth the comments of the examiner with emphasis upon what the examiner considers to be deficiencies in the registration statement. Those comments should be presented in a form which will permit them with as little change as possible to be incorporated directly into a letter of comment (often called a "deficiency letter") to be sent to the issuer. The literary style of the report should be acceptable and the grammar should be correct. It is not important or even contemplated that the literary style be exciting, or even very interesting. It should not be repetitious and, most important, the language used should convey the meaning intended clearly with as little ambiguity as possible. Much of the difficulty we have had in dealing with persons filing registration statements comes from a break down in communication, i.e., a failure to understand each other. Words should be used as carefully and accurately as possible. Slang clearly has no part in a letter of comment. We are very sensitive about the letters we send out, for they may find their way through many hands and are sometimes displayed in public.

Second, the examiner should state in his report those areas of disclosure which appeared to present problems and which he investigated even though his final conclusion is against citing a deficiency. His reasons for not citing a deficiency in those areas should be succinctly stated. This is particularly important where the disposition of a point may have arisen from putting together material that appears in various parts of the registration statement. For example, something on page 2 of the prospectus may raise a question but the answer is supplied by material on pages 5 and 7 together with note 13 of the Summary of Earnings on page 21. It is highly desirable to record that in the examiner's report so that the section chief can readily trace the steps and be satisfied that the analyst's inquiry into the matter was adequate.

After the section chief reviews the examiner's report, the letter of comment is prepared for review and sent to the Assistant Director's office. One of the things that should be included in the letter of comment is an inquiry with respect to the proposed time schedule of the registrant where it has not been furnished to us. We ask the company when it wants the registration statement to become effective.

Usually the registration statement will be amended promptly in response to our deficiency letter. Rules 470, 471, and 472 are the principal rules governing amendments. A typical amendment comprises a facing sheet which identifies the amendment, as amended prospectus, and a set of signatures. Three copies of the amended prospectus are required. In a typical registration statement the first material amendment will dispose of the matters mentioned in the letter of comment. A further amendment will usually be filed immediately before the registration statement becomes effective to set forth the offering price, underwriting spread, proceeds to the company, and the complete list of underwriters. The analyst must prepare a memorandum for each amendment to record the results of the examination of the amendment. In

a typical case the registrant will ultimately be informed that the Division has no further comment regarding the registration statement. The registrant will then inform us that the price amendment will be filed on a specified date and request that the statement be declared effective on that date.

At this point the analyst will prepare a clearance memorandum. The form of the memorandum is set forth in a Division memorandum of administrative practice. It sets forth the securities registered, the method of offering, the business of the company, a statement of the problems in processing the registration statement, and certain statistical data. Usually the complete offering data will not be available, and a so-called preliminary clearance memorandum omitting such data will be prepared.

Five copies of the preliminary memorandum and copies of the most recent prospectus are transmitted through the office of the Assistant Director to the Commission at least one full business day before the statement is to become effective. This step is to advise the Commissioners that the statement will be presented shortly for action by them, and provide an opportunity for them to become familiar with the statement. Where necessary the registration statement may be presented without such notice to the Commission.

Upon filing the so-called price amendment, a clearance memorandum in final form is prepared. The registration statement is then presented to the Commission by an Assistant Director or Branch Chief.

After the statement becomes effective, a final form of prospectus is filed under Rule 424C. After such prospectus is examined to determine that it is in accordance with all prior piece-meal amendments, the analyst's work on the registration statement is complete.

I have here passed one step of the process in order to dispose of the entire mechanical aspects of declaring a registration statement effective. Let us now go back to the price amendment and the request that the statement becomes effective on a specified date.

You will recall that the Act provides that the registration statement will become effective in 20 days by lapse of time. If it is not practicable to file a material amendment within such period, a delaying amendment is filed, usually by telegram. Such amendments are governed by Rule 473. Pursuant to Rule 478, only the signature of the registrant or the agent for service is required on a delaying amendment.

The filing of an amendment, either a delaying amendment or a material amendment, establishes a new filing date for the registration statement under Section 8 of the Act, and the 20 day waiting period commences to run again. Assuming that the expiration of the 20 day period does not coincide with the date the registrant wishes the statement to become effective, a request will be made that the Commission exercise its discretionary authority, conferred by Section 8(a) of the Statute, to accelerate such period. Rule 461 requires that such request be made in writing by the registrant, the managing underwriter, and the selling stockholder, if any. Rule 460 sets forth that the Commission will consider in ruling on requests for acceleration: the adequacy of the information in respect to the issuer, theretofore available to the public, and whether

reasonable steps have been taken to make information in the registration statement conveniently available to underwriters and dealers who are expected to participate in the distribution.

The Act provides that the Commission may shorten the 20 day waiting period, having due regard to the adequacy of the information heretofore available to the public, the facility with which the nature of the securities to be registered, their relationship to the capital structure of the issuer and the rights of the holders thereof can be understood, and to the public interest and protection of investors. This brings us to the "90 day" rule and the "6 month" rule. Applicable rules are found in the instructions as to financial statements in Form. Briefly, a registration statement must contain financial statements as of a date (1) within 90 days from date of filing the registration statement, or (2) within six months of the date of filing of the registration statement if all of the following conditions are met: First, the company files annual reports under Sections 13 or 15(d) of the Securities Exchange Act; second, the total assets, exclusive of any qualifying reserves and exclusive of intangibles, amount to \$5,000,000; third, the long-term debt is not in default as to principal or sinking fund. If these terms are not met, the 90-day rule and financial statements must be as of a date 90 days from the date of filing.

Inasmuch as a registration statement is deemed to be filed anew with the filing of each amendment, it sometimes happens that by the time the last amendment is filed more than 90 days (or six months as the case may be) has elapsed from the date of the most recent financial statements. In such instances and if the Commission is convinced that the public interest requires the exercise of its discretion to that effect, the Commission will consent its power given by Section 8(a) of the Act that one of the amendments be deemed as filed at an earlier date and therefore grant what we refer to as "protection" to the financial statements. This is not done until the time of clearance. At the time the clearance memorandum is prepared one of the things that must be stated is whether the financial statements require "protection."

The date as of which financial statements will be protected is chosen by taking the date of filing of the last amendment filed within the 90 day period (or within the six-month period). The Commission will consent that any amendment filed thereafter shall be deemed to have been filed as of the earlier date.

In cases where the Commission protects financial statements, the order declaring the statement to be effective will give the actual effective date and also state that the effective date is "as of" an earlier date which will ordinarily be 20 days after the date chosen for protection of financial statements. The "as of" date is important because it governs the computation of the period in Section 10(a)(3) of the statute which provides that where a prospectus is used more than nine months after the effective date of the registration statement, information set forth therein shall be as of the date not more than 16 months prior to such date.

We have mentioned Section 10(a)(3) of the Statute and the necessity of a revision of the prospectus where the offering continues well into the future after the effective date. Open-end investment companies are the most frequent example of the continuing offer. There is also the case where securities of an issuer remain unsold and further efforts are being made to sell the securities. In each case an up-to-date prospectus is needed.

Quite apart from changes required by Section 10(a)(3) after a lapse of time, if there is a substantial change in the affairs of the company during any of the offering period, the prospectus should be revised and supplemented to set forth that circumstance. Such supplement or revision or an up-dated Section 10(a)(3) prospectus would be filed in the form of a post-effective amendment. The post-effective amendment is examined as the registration statement is examined. However, the statutory 20-day period does not apply to such amendments in any way. There is no necessity for delaying amendments. Post-effective amendments will become effective only upon action by the Commission.

Post-effective amendments are to be distinguished from minor changes in a prospectus made after the effective date which changes are made by stickers or supplements to the prospectus. These revisions are filed under Rule 424(c) which does not require the formality of a post-effective amendment or that signatures be furnished. If the change is more substantial, it might be desirable that the full formality of a post-effective amendment be used.

Other examples of continuing offerings other than unsold allotments or open-end investment companies are instances where warrants are outstanding and have a relatively long life. A number of companies continually maintain a prospectus which meets the standards of Section 10(a)(3).

Last December the Commission adopted Rule 434-A for a "summary" prospectus. This prospectus may be used either before or after the effective date. But the use of the summary prospectus is restricted to registration statements on Form S-1 and S-9 and to companies which are currently filing reports with the Commission pursuant to Section 13 or Section 15(d) of the Exchange Act.

The summary prospectus is obviously suited only for the use of relatively high-grade offerings by established companies. It was intended to be a convenience for the underwriting fraternity. The rule provides that there shall be a five-day waiting period -- five business days -- between the filing of the summary prospectus and its use. The policy of the Division is that the summary prospectus shall be examined immediately and that if at all possible comments will be communicated to the company in sufficient time to permit any necessary revision so that the prospectus may be used on the fifth business day. In practice this means the examination of the registration statement is substantially completed before the comments are given on the summary prospectus. There may be details about exhibits and minor matters in notes or tables to financial statements, but it is not our practice to give comments with respect to the summary prospectus where it appears that there will be a substantial comment in regard to the full prospectus. Our standing instructions call for furnishing the summary prospectus immediately when filed to the Assistant Director and the Branch Chief, and they also call for the Section Chief himself to go to work on it. That is one of the priority and pressure items that the Division has.

Now I should like to impose one more thing on you. What does the conscientious analyst do about preparing himself for his work in the Commission? I want to call your attention to a few items of bibliography which I believe to be helpful. One is Security Analysis by Graham and Dodd; Dewing on Financial Policy of Corporations; Understanding the Securities Acts by

McCormick, particularly the chapters with respect to stop-orders which have been issued and the types of comments which are set forth in letters of comment; and Securities Regulation by Loss. Then there is a review of the Commission's work set forth in the 10th Annual Report of the Commission to the Congress and current comments in the 22nd Annual Report. I have already mentioned that an analyst should have some acquaintance with accounting. A book has recently been written on Accounting and the S.E.C. by Rappaport; also Report Writing for Accountants by Palen.