DIVISION OF CORPORATION FINANCE

TRAINING PROGRAM LECTURES

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Subject: Filings under Regulation A

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MR. GLAVIN: My principal purpose--during this brief discussion--will be to give you a general idea of Regulation A from the point of view of Commission administration and some particulars as to its importance in order to create a greater awareness and livelier interest in this subject matter and its importance to the Commission and the public interest.

I have no doubt but that the administration of Regulation A is a most important work of the Commission, at least in terms of the number of members of the public affected by offerings thereunder. The number of filings has been running at the rate of 1500 a year with upwards of $300,000,000 of the public's money taken in as a result of such offerings. Thus, in a word these offerings bear watching and in the case of some -- apparently a large percentage -- fast investigative action. However, it must be emphasized that there are many good -- bona fide -- companies that avail themselves of the Section 3(b) and Regulation A exemption.

You are all staff members and are acquainted with Regulation A, some of you quite closely. Without question Grace Clawson here knows more about the regulation than any other person. If she weren't so modest and reluctant she would be giving this lecture and thus, I daresay, it would be a better one. As you know, there are other regulations than Regulation A under Section 3(b). However, I am confining my remarks to Regulation A, by far the most important of the 3(b) exemptions. Since we all know the regulation, I'm going to talk around it so to speak and not take it rule by rule. Generally, we'll cover its history, the processing job under the regulation, the suspension procedure, our coordination program with the State authorities in connection with Regulation A, and something of the Branch of Small Issues and the current status of the regulation itself, as well as what is indicated to be ahead as to its survival, growth or contraction possibilities.

As to the history of the regulation: As we look at it today in retrospect it can certainly be said that Regulation A has grown up considerably. In its present context, as to its requirements, it isn't too far from registration. The Commission has been alive for 23 years, and Section 3(b) has been in the 1933 Act all that time. Since the effectiveness of the 1933 Act we have had various rules, according to which offerings were permitted to be made pursuant to the 3(b) exemption from registration. In the early years the rules applying to these offerings were all made relatively simple and offerings thereunder very rarely, if ever, were policed. The original

qualifications requirements necessitated no more than the mere filing of a notice or letter advising that a sale was to be made. The "ceiling" for offerings under 3(b) originally was $100,000, and that was increased in 1945 to $300,000.

The first Regulation A, as such, is about fifteen years old. That regulation was a big step from the rules which preceded it. Generally, the requirements of the first Regulation A were that there had to be filed what was known as a letter of notification, which was prepared on a form known as S-3b-1. This called for the name of the issuer, its address; names and addresses of the officers and directors; the underwriter, if any; the offering price and selling commission; the jurisdictions in which it was proposed to make the offering; and the use to which the issuer intended to put the proceeds. An officer or insider could make an offering under the original Regulation A and much more easily than such a person can today. An insider can no longer "bail-out" under Regulation A if the issuer is not beyond the development stage or without net earnings from operations. As you can see, the old S-3b-1 form was quite simple. If an issuer chose to have an offering circular (there was no requirement then that it do so) it had to file it. But if it filed it there was no requirement that it use it. In the New York office we took that filing requirement and bureaucratically stretched it to require that an issuer, seemingly without bona fides, give us assurance that it would use such an offering circular if filed. Of course, there was no suspension procedure. There was nothing at all you could do in the way of obtaining administrative relief and unless the offering circular exhibited fraud on its face, no other action was considered. There was a one-week waiting period before the offering could be commenced. In these early years of the regulation nothing much was done with the letter of notification except to superficially review it, and unless there was some striking deficiency it was, much more often than not, committed to the files.

From the time of the first Regulation A the notifications were filed in the regional offices – as they are today. In the early years the processing was **not too uniformly performed, and it wasn't 'till about the late 1940's** that, seemingly, anyone gave much thought to determining whether any of those offerings required investigation, much less action. Offerings under the regulation were just not considered of sufficient importance to require much attention -- except in very isolated instances.

The first real formal recognition that offerings under Regulation A had more than a little effect on the public interest came in March, 1953, when the Commission gave us what began to look more like an S-1, and some of the requirements of registration were brought over as conditional requirements for reliance on Regulation A. In addition, the revision of 1953 gave us the all important suspension procedure. However, even then, it took a relatively long time before we made full use of this procedure as an effective enforcement weapon.

There were not many suspensions in the first year after the 1953 **revision** (less than ten), but as the months went by and the regional offices became aware of the effectiveness of this suspension procedure more and more suspension orders were sought and obtained. The total of these suspension orders for fiscal 1956 reached 100, and right now we are going at the same rate or in excess of it and should have 130 for the fiscal year 1957. True, many of these orders have been based on technical grounds such as failure to file the 2-A report, the status report, but four

out of five orders obtained in recent months were orders that were obtained because of the presence of fraud.

Up to a year or so ago, it would seem that many of the regional offices felt their job had been done in most instances when a warranted suspension order had been obtained, even though the order had been obtained, even though the order had been based in part on fraud or misrepresentations by the underwriter in connection with the offering. Wasn't some other action required? What about revocation proceedings?
Needless to say, such further action is recommended now whenever appropriate as part of our follow-through procedure. There have been a good number of instances where, after getting the suspension orders, we didn't stop, but went right on to follow through by having those matters readied for criminal reference. Several broker-dealer revocation proceedings have been commenced simultaneous with, or shortly after, issuance of the suspension order. In one instance recently an injunction was obtained right on top of the Regulation A order. The theory behind the follow-through is to use all our tools to get the maximum result against all those who have violated the law in material respects -- not **just** to be satisfied with a "stop" against the issuer.

Our procedure of "follow-through" of course is important, but it is overshadowed by what I consider the most important part -- yes, the most important part -- of our over-all job under Regulation A, and that's called the follow-up. Let me explain what I mean by "follow-up." As I've said, back a few years ago it was generally thought by most staff members concerned that once the filing was cleared, once they had finished the processing job, they were through with the filing. This feeling was understandable for it had been a tiring struggle to get full disclosure in many of the filings even though they had little to disclose. The notification was filed away, and the processing people didn't want to see it again. Mine you now, the type of filing I'm talking about is one wherein good judgment would force the conclusion that, since the issuer and its offering circular showed nothing to warrant the purchase of the stock, it had to be sold by pressure and false representations. But a year or two after the file was closed -- and the issue sold -- a little old lady who had bought securities under the filing would come into the regional office and say: "They told me it was going to be listed on the New York Stock Exchange -- it would be worth $10 a share in six months -- the company was doing better than Radio Corporation of America." Or, another complaint more recently: "They told me they had uranium piled up on their property." If you wait you'll surely get the complaints, and we did. Then we investigated -- but late -- and the result after much more time -- a broker-dealer revocation. But in the meantime that underwriter had sold several issues under other Regulation A filings and, of course, the full amount had been obtained on the original filing as to which there was now no equity for action. The point is that we should investigate offerings promptly after their commencement wherever sound judgment forces the dual conclusion that the issue is entirely without merit, and if it's to be sold, fraud must be indulged. That's the follow-up. To investigate those issues where you have a strong suspicion -- and by applying plain common sense to the filing you have before you -- sound judgment forces you to the conclusion that fraud must be afoot. Incidentally, this exact same follow-up procedure can and should be applied to similar type registered issues. The Act says we can't pass on the merits of any securities; but we are not prevented from making the internal judgment I described. We're derelict if we don't, and when that decision is reached we must investigate -- and quickly -- in order to stop the entire

issue from being sold when we find our suspicions are realities. The type of investigation called for can be made quickly and with relative ease. You get the names of some buyers and find out what they received and have been told. The follow-up has demonstrated to be a productive procedure; the only trouble is it has been indulged in too few cases -- the principal reason is lack of personnel and the otherwise heavy workload.

Regarding our suspension orders and hearings thereon, it is striking that although more than 200 orders have been issued, less than a dozen hearings have been requested. Those hearings in almost all instances have been handled by field attorneys. The Commission's decisions on those which have been concluded have given us good precedents on a number of points and in all the staff has **been upheld. The large number of orders issued and the decisions** rendered in the completed matters have been given wide publicity, and together with the results of our "follow-ups" have had -- I believe -- the good effect of exploding the belief of some that Regulation A was no more than a license for fraud.

We have taken a big step in coordinating our Regulation A activities with the State Securities Commissions, and we are getting very good results in that respect now. There was a State Administrators' conference about a year ago, one result of which is that the State Securities Commissions are getting aid from the Division here, and they are reciprocating. To illustrate: Take the situation where an issuer qualifies under Regulation A, the filing is cleared so to speak by the Regional Office and the offering made in perhaps twenty jurisdictions, all named in the notification. However, the issuer had not qualified as required in several of these. The Administrators asked to be notified in advance of these offerings. We now do that by sending out weekly notices containing data on Regulation A such as the jurisdictions which were named in the notification in which the securities were to be offered. This information enables the Administrators to take action as they see fit before an offering is made within their borders. Some promptly issue cease and desist **orders.**

A number of State authorities are now sending us all sales literature received by them for their residents who have been solicited thereby. On a number of occasions we have used such material to support charges in our suspension orders where the communications were used in connection with a Regulation A offering and either had not been filed or were used in a jurisdiction not named -- as required -- in the notification.

Now a word or two about the Branch of Small Issues -- which also lacks personnel badly. It was created last August. Its function is to supervise the work of the regional offices in so far as Regulation A is concerned and to coordinate such activity in that area. The Branch is responsible for the proper performance of the Regulation A task assigned to the regional offices under the Commission's stated Regulation A **procedures with implementing** authority through the Division of Corporation Finance. The Branch is the liaison between the Commission and the regional offices. In addition to its supervising and coordinating responsibility, the Branch was created to aid the regional offices in the Regulation A field. It is and must continue to be the point to which the regional offices may turn with any problem related directly or indirectly to the regulation.

Regulation A, as recently revised, is a good regulation -- with substantial disclosure requirements and with teeth -- and aside from some of the minor amendments now in contemplation, it should last substantially as is far longer than its predecessor. The Senate has a bill to increase the ceiling to $500,000 which probably will be voted this session. However, it's highly unlikely that the House will give its approval. As you might know, one particular Congressman has a bill in the hopper which, if it comes out, would do away with Section 3 (b). There wouldn't be any exempt offerings; that's like cutting off your arm to cure a sore finger. There aren't many people who agree with that approach. There are other bills which would have an effect on Regulation A. One of these, the alternative bill to the one amending Section 3(b), is one which basically would impose civil liabilities similar to the Section 11 liability for registered issues. There hasn't been too much backing apparent for this bill. In my opinion, if we do a good processing job and fully implement our follow-up procedure there would be no need for the additional legislation contemplated by any of the currently considered bills.

In conclusion let me say that Regulation A, in terms of the Commission's over-all mission and the public interest, is big business and is so viewed by the Commission itself. Thus we **who** have to do with its administration may rightly feel ours is a very important **work** which, if done well, can return a substantial measure of personal satisfaction as well as a real public service.