DIVISION OF CORPORATION FINANCE

TRAINING PROGRAM LECTURES

Twenty-fifth Session – May 16, 1957

Subject: Processing of Applications for Registration of Securities on Exchanges

Speakers: Mr. Rayborn Clifton, Chief, Office of Filings and Records
Mr. Maxwell Kaufman, Section Chief, Division of Corporation Finance
Mr. Benjamin Levy, Section Accountant. Division of Corporation Finance

MR. CLIFTON: There are two things that I should like to talk about today: First, the five exemption rules under the Exchange Act, under which securities are traded on exchanges without registration or, at least, temporarily without registration; and the other is the present acceleration policy for shortening **the 30-day** waiting period under the Exchange Act for admission of securities to trading on the exchanges.

The first three exemption rules are purely historical insofar as any new admissions to trading are concerned. Rule X-12A-1 provides a temporary exemption for certain bank stocks. Some of you may have been misinformed, for I have heard several of you say that banks are exempt from registration under the Exchange Act. That is simply **not so.** There were certain banks whose stocks were listed on exchanges on June 30, 1935. Only those banks are exempt under that rule. There are only eight of them today. There were about 37 in 1935.

The reason that these bank stocks are still temporarily exempt after 22 years is that the Commission has **never** adopted a form specifically for the registration of these bank stocks. The reason for that is that they have never been able to reach an agreement with the Comptroller of the Currency who administers the National Bank Act. There is apparently a direct conflict between Congressional purposes involved as to the disclosures required by the Exchange Act and the disclosures prohibited under the National Bank Act. It is simply this: Our Act requires certain disclosures of information as to earnings, profit and loss, etc. No bank may make that information public without the consent of the Comptroller of the Currency. We had ten years of that conflict in the Trans-America case. Until such time as we adopt a form applicable specifically to banks, these banks file nothing with us at all. As I said, there are now eight banks whose stocks are traded under this Rule. They are all on the Philadelphia-Baltimore Stock Exchange; they are all traded on the Washington branch of that Exchange; and they were all inherited from the old Washington Stock Exchange. That Exchange was set up about 1871, as a sort of bank president's club solely to trade in bank stocks. Riggs Bank is one of those original banks, and it has been **on the Exchange** since the very beginning.

There have been five banks that have filed an application for registration of their stock on exchanges under the Act since June 30, 1935. Three of these are still on an exchange -- all, again, on the Philadelphia-Baltimore Stock Exchange. **They do not** file annual reports on Form 10-K, although they are registered on the basic forms. The reason for not filing Form 10-K annual reports is that the Commission informed us some years ago (not the present Commission, but a previous Commission) not to insist that these banks file annual reports until we adopted a form specifically for banks, as we would run into **this** problem of disclosure with the Comptroller of the Currency in each and every case.

If a bank wants to register now, we tell them that they can use Form 10; that under Instruction 15 to Form 10, relating to financial statements, we will accept the statement of condition as of the most recent date called for by the Comptroller of the Currency, a statement of profit and loss, analysis of undivided profits or surplus for the past three fiscal years provided the Comptroller has no objection to making such information public. Of course that probability of refusal actually never arises because no bank **would** approach an exchange for listing if it couldn't make its profit and loss statement public.

Rule X-12A-2 will take only a moment; there are only two bond issues left under this Rule. Originally there were about 25 bonds under this Rule. These were the bonds that were listed on the exchanges, again on June 30, 1935. When we started examining the Form 12 applications of certain railroads, and Form 12-A applications which were filed by the receivers of certain railroads, it was found that although they were servicing certain bonds, that is, paying the coupons, they had not formally assumed the obligation for paying the principal on those bonds. Therefore, they were not the issuers. These were first mortgage bonds on mainlines in many cases. Some of the railroads that have formed transcontinental systems taken over other railroads without assuming their bonds. Under the Exchange Act only the issuer can register. No issuers existed for these bonds on properties taken over. The issuer was the original corporation which had long since gone out of existence. So, we adopted this particular rule to require the companies that were servicing these bonds to carry them on the facing sheets of their reports and to include information on **them**. As I have said, there are only two such banks left, one of which matures in 1987, and the other in 1990. So far as I know there will be no problem until they come due, and I don't suppose that will worry any of you right now. The temporary exemption provided by that rule terminated April 30, 1936. No other bond can come under it. No **provision** was made in the rule at that time for any continuation of that exemption to a successor issuer. I recall one case in which a bond came due in 1937, and the I.C.C. required the original company to be re-incorporated (its charter **had** expired in 1871). Directors and officers had to be appointed so they could sign an application and file it with the I.C.C. to extend the maturity of that bond. That procedure also solved our problem because those same people could now file an application for registration of that bond on the exchange.

Rule X-12A-3 was adopted to permit the continuation of the listing after June 30, 1935, of securities of certain issuers which were then bankrupt or in receivership. There were about 50 or 60 of such companies on exchanges when the S.E.C. came along. They were some of the remains of the Great Depression. All of the securities of these companies have long since come off the exchanges. There is no use for this rule right now because no other securities can come under it.

Those are the three historical rules. Altogether there are only ten securities under those rules, so I don't think you should concern yourselves too much about them.

There are two very active and live rules: Rule X-12A-4 and Rule X-12A-5. Rule X-12A-4 **provides** an almost **automatic** conditional exemption from registration under the Act for trading subscription rights on exchanges, both on a "when issued" and the "regular way" basis. Since the only person who has to file anything under Rule X-12A-4 is the exchange itself, the administration of this rule is centered in my office, specifically on Mrs. Shinnick's desk. She maintains the current calendar on rights trading, and when she calls the examiner, Branch Chief, or Assistant Director and says she has a "rights case" to clear today, she means exactly that, because that is what she has on her calendar.

The principal condition for exemption under this rule is an effective registration statement under the Securities Act. That is the one condition that the exchanges cannot know unless we tell them when the registration statement becomes effective.

Rule X-12A-4 in its present form was adopted December 29, **1952**. Prior to then the rule for trading rights required the filing of exemption statements, certifications from exchanges, a fixed waiting period, telegraphic notices, clearance **memoranda**, and frequently, acceleration orders--all to trade rights. All of this was a real mountain of paper work. It came on the examiners at the very time they **had** all of their paper work under the Securities Act **to** do. I think everyone was glad to be rid of this paper work to permit trading in rights. However, the exchanges, particularly the New York Stock Exchange, the Midwest Exchange, and the American Stock Exchange, which have about 100% of all the rights trading, had misgivings as to **how** they could operate under the new rule if they had no way of knowing whether and when, the major condition of the exemption was met. The Division agreed to **telephone** them collect, and assigned to my office that duty. That is why Mrs. Shinnick on a certain date calls certain people concerned on a particular case and asks them to let her know when the case clears. When the 1933 Act statement clears in the morning before or by 11:30 the exchanges can make their required advance notices on the ticker-tape and on the **broad-tape**, so that they can commence trading in the rights by 12 or 12:30, provided we can call them and tell them it is all right to trade. If the 1933 Act statement does not clear the Commission by 11:30 or by noon, the exchange does not want it cleared until 3:30, or shortly thereafter. The reasons for these particular times of day for clearance of the 1933 Act registration statement involving subscription rights are quite technical, and you will just have to take my word for that now because there is not time to explain it.

Where the registrant's counsel understands these matters, and particularly where the managing underwriter is a member of the exchange, there is very good cooperation in putting into their requests for acceleration these particular times of day. Where the managing underwriter is a non-member, less frequent attention is paid to the requirements of the exchange.

There are a lost of problems involved in this, but with my limited time I just better skip them.

Under Rule X-12A-5, whether you work in the Division here or on the outside handling the listing and registration of securities on exchanges, you will find that Rule X-12A-5 is your most used and useful rule in setting up your time schedules for (1) commencement of trading on the exchange, both "when issued" and "regular way," and (2) preparing, filing and processing the applications for registration. This rule takes the pressure off everybody concerned: the exchange that wants to get out notices fixing a **subsequent date** for the commencement of trading; the company and the attorney who know that the application for registration can be prepared in the past tense and filed with the Commission and the exchange after trading commences; and the staff here who know that the acceleration of the 30-day waiting period will not be necessary. In substance, this rule says that whenever a security traded on an exchange comes to evidence, by operation of law or otherwise, another security in substitution for or in addition to the traded security, such substituted or additional security shall be temporarily exempted from registration to the extent necessary to render lawful transactions on the same exchange in the substituted or additional security.

In March of 1955 this rule was re-written to include two additional classes of cases under that rule, namely, voluntary exchange offers, and securities offered to holders of presently traded securities through subscription rights. Previously we had to accelerate all of those cases if the time schedule called for it. Moreover, the security entitled to be traded under this rule may be of the same or different issuer. The temporary exemption is good for 120 days, not from the date when the substituted or additional security was created or offered, but from the date when the exchange by its own action officially admits the substituted or additional security to trading as an exempt security. The reason for putting this particular provision in the rule was to take care of the cases where, unknown to the exchange, or to us, certain events took place which created a new security, so that by the time the exchange found out about it the 120 days could have already run.

What kind of securities, or situations are entitled to be traded on exchanges under this rule where the issuer can take its time to file the application, and where we are not pressed for time to examine it, process it, get out **orders, etc.?** Here they are: Classes of securities issued in mergers, **consolidations**, voluntary reorganizations, dissolution plans under the 1935 Act for public utility holding companies, exchange offers, offers through subscription rights, and stock dividends payable in another class of stock. Note that the exemption is available to the entire class of the new or additional security even if only a part of the class goes to the holders of the class of security traded on exchanges. Note also that the exemption is good only on the exchange where the original security is traded. This is quite important because it means that if the new security is going to be traded, say, on the New York and Midwest Exchanges, and only the holders of the common on New York have the right to get this new class, Midwest was no exemption and would undoubtedly request acceleration to permit trading to commence on that exchange at the same time as it does on the New York Stock Exchange.

One sure way to determine whether the new class of securities entitled to be traded on a particular exchange under this rule is to ask yourself "What security on X Exchange evidences or has the right to acquire this new class, all or any part?" If the answer is **"none", better** forget about the exemption, advise the lawyer who is working on the case to get busy and file his application for registration and request acceleration because he has no exemption.

There is a very rare exception to this involving "when issued" trading, and you may never have a case like it, so I don't think I shall go into it. There have been only two such cases, I think, in the history of this rule.

When you are working on a proxy statement, or a registration statement under the Securities Act, or for that matter on the **Forms 10 or 8-A,** if you are not sure that you understand the time schedule for the commencement of trading, or you are less sure that the company understands it, my advice to you is to raise the question promptly. I don't think you should hesitate to call me or come in to see me. Any doubtful cases ought to be ironed out here before we talk to the outsiders. Any off-base opinion on the availability or non-availability of the temporary exemption from registration filed in the opinion of counsel with the listing application for one of the exchanges **can be most** embarrassing when the exchange refuses to accept it, as in the recent United Wallpaper case.

So much for the exemption rules.

As to the acceleration policy under the Exchange Act:
Acceleration of the effective date of registration of a class of securities on a national securities exchange is authorized under the last part of the first sentence of Section 12(d) of the Act. We have one rule on acceleration under Section 12(d); this rule merely says that the request shall be in writing, that it may be made by either the issuer or the **exchange,** or by both, and it should state the reasons for the request. These requests are included in the Division's daily memo so that the Branch Chief and Assistant Director and others concerned can be alerted. The acceleration request comes first to my office. Mrs. Shinnick maintains a Division calendar of pending applications for registration on the exchanges, certifications of exchanges, acceleration requests and time schedules, as well as the effective date on the particular exchange involved on every security registered on every exchange since July 1, 1935. My office is the one place in the Commission you can find such information, namely, what the effective date of registration is of a particular security. That is the one central place. There are other ways to find such dates, but they are quite laborious.

When Mrs. Shinnick gets the acceleration request, she usually calls the examiner and **informs him of** the request and the time schedule involved. Unless the acceleration request is included in the application for registration or in the exchange's certification, it goes in the --3 correspondence file. The reason for this is that the letter containing the request usually discusses other matters.

If, and when, the Commission grants the request on the recommendation of the Division, or when the Branch Chief or the Assistant Director initials the recommendation for cases that do not have to go first to the Commission, all the files and the six copies of the acceleration recommendation go back to Mrs. Shinnick. She gets out the telegraphic notices to all the parties concerned, exchanges, counsel, and others: types the Commission's order; distributes the six copies of the clearance memorandum or acceleration report to the parties involved; prepares a memorandum to Margaret Hould giving the names and addresses of all the parties on whom the

order is to be served and sends the order to the Secretary's Office for signing and **affixing** the Commission's seal and for entering in the Commission's minutes. So much for the details.

What do we do when an acceleration request is unnecessary or premature? In the first place, we don't sit on it or ignore it, for the reason that it has been determined that since registration itself is defined, in the light of the Administrative Procedure Act, as a licensing procedure, the acceleration request which relates to such registration is an agency proceeding and must be handled accordingly. Failure to act on an acceleration request is a form of denial prohibited by Section 6(d) of that Act. Accordingly, we must either grant the request or notify the applicant and the exchange why we intend to disregard it, or that we will consider the request for a later date. It is not necessary for the issuer or the exchange to write us a letter withdrawing the request. Our counsel has ruled that we comply with the Administrative Procedure Act when we merely inform the registrant on the exchange that we are going to disregard the request. When an unnecessary or premature request is made by the exchange, I handle that in my office. Of course I notify the examiner and the group of the action I take.

Where the unnecessary or premature request is made by the **company or its** attorneys, the examining sections handle the matter through the Branch Chief. Of course we have to work together, so you will **usually** find a marginal note I have made on the request suggesting the procedure the Examining Section should follow. Such actions will then tie in with what I am doing with the exchanges on the case. On the other hand, the Examining Section should certainly let me know if the request cannot be recommended for the reason that there **are deficiencies** in the application. There is no objection at all to handling these cases by telephone, or orally if the attorneys are here. **Of course,** appropriate **memoranda** should be prepared for the file, or an appropriate notation made on the request as to what action was taken.

The most frequent reason for rejecting a request for acceleration is that it is unnecessary because of the temporary exemption under Rule X-12A-5. The exchange can trade under that Rule before the 30-day waiting period expires. However, there are other reasons for acceleration than to permit trading to commence on exchanges in advance of the statutory waiting period. There are about three classes of such cases: Acceleration is requested to permit investment in the securities in certain States under their legal investment laws. The second class of reasons for acceleration other than to permit early trading on exchanges has to do with cases where contracts or other legal documents are drawn using the specific language (registered under the Securities Exchange Act of 1934). Counsel takes the view that trading temporarily exempt under Rule X-12A-5 will not be in accordance with the terms of such contract or such agreement. There are certain law firms that take the position that certain State laws, called Blue-Sky laws, are not met by trading under Rule X-12A-5.

The third class of reasons why we accelerate other than to permit early trading on exchanges, I call personal reasons because they usually have to do with companies that have already printed their reports to stockholders, already printed publicity announcements, and used the words listed and registered. There is no point in arguing with them that they should reprint to explain trading under Rule X-12A-5. It is much easier for us to accelerate.

So, where we advise the registrant that acceleration is not necessary to commence trading prior to the lapse of 30 days because of Rule X-12A-5, we must always give the registrant an opportunity to continue or renew the request on one or more of these other grounds. Even though you may not agree with the new reasons, long experience has taught us that you will save a lot of time by just accelerating without argument.

I can express our policy negatively better than I can positively. First, we do not recommend acceleration where it is not necessary under Rule X-12A-5 unless, as I have just explained, **there are** certain other reasons than to permit early trading. Second, we do not recommend acceleration of new bonds or preferred stock issues, offered for cash sale through underwriters to the public until the issue has been distributed and the agreement among underwriters terminated. Again there are exceptions.

One of these, which I just gave you, is where the acceleration is necessary to permit institutions in certain States to invest under their legal investment laws.

Another exception is the case where substantially all of the issue has been distributed; some of it hasn't sold yet, but the market restrictions have been removed -- in other words, a sticky issue. If it is say, 80% distributed, there is no point in denying an exchange market to the holders.

We do not recommend acceleration where an investigation is going on, or where we have reason to believe that the listing may be part of a scheme of distribution in violation of the Securities Act. That happens sometimes on the Western mining exchanges.

In no case do we recommend acceleration until we can assure the Commission I think the best explanation of that policy is contained in a letter I wrote to Walter Hawes, Treasurer of the Midwest Stock Exchange. He had requested acceleration of registration of securities of a company that had made no previous filings with the S.E.C., I said to him:

> "It is the present practice of this Division not to recommend acceleration until we can assure the Commission that the requirements of the appropriate form and regulations relating **thereto have been substantially met**. Such assurance must be given to each Commissioner by memorandum from this Division at least two days in advance of presenting our recommendation to the Commission in session. Our letter of comments on the Form 10 application was mailed to the Southwest Manufacturing Company and a copy to your Exchange on December 5, 1956. When the amendment requested is filed and examined, your request for acceleration will be considered. We do not know at this time whether your date of December 17 can be met."

We did accelerate in this case, but not on December 17, because the amendment wasn't filed until later.

Now, here is Mr. Kaufman.

MR. KAUFMAN: I shall try to tell you in about 10 minutes how to examine Forms 10, 8-K and 10-K.

The basic form for registration of a security under the 1934 Act is Form 10. Since that is the basic document, it ought to be complete because that is going to be the foundation on which all subsequent reports are based and will tie in to. That calls for a thorough examination of the Form 10. From broad outline you will find that Form 10 is in many respects similar to a registration statement under the 1933 Act, for example, Form S-1. Some of the items in it are very much the same as in Form S-1. Some of the items are also the same as some of the items that appear in Schedule 14A of the proxy rules. That means that what you have been told about examinations of Form S-1 and proxy statements is applicable to the examination of Form 10.

What I should like to do, if I can, is to pick out some of the key items in Form 10 and perhaps illustrate the type of disclosure that should be obtained. We take a very broad approach in examining these things. In other words, we don't stick literally to the wording of the **items**. **We** go rather far beyond it.

One of your important **items, for example,** is Item 3, which is the description of the business of the company. We have found some cases of a small company where we might have the profit and loss statement for the three-year period, and this may not be indicative of any particular trend. The company may be a sort of speculative one, not well established. We have not hesitated in such circumstances to say, "let's have a five-year summary of earnings, right up under the description of business, to point up the trend and find out which way the company is going." That is not done all the time. You won't find anything in Item 3 that calls for that, such as in Item 6 of Form S-1.

Item 3 calls for a brief description of the business done and intended to be done by the registrant and subsidiaries, and the general development of such business during the past five years. If they produce different kinds of products, or different kinds of services, some indication is necessary of the relative contribution of each of those products or services to the business of the company. The item also calls for a statement as to general competitive conditions in the industry in which the company happens to be engaged.

I have a letter here that went out to a manufacturing company in which we pointed out, first, that as required by paragraph (a) of this item there should be disclosed, insofar as practicable, the relative importance of each product, **service, class** of similar products or services, which contributed 15% or **more to** the gross volume of business done during the last fiscal year. We also asked **that the** company point up the significance of foreign business. We also suggested that the amount of orders on hand as of the most recent practicable date and as of a year ago, broken down as between civilian business and defense business, be disclosed. In other words, that would help to point up which way the business is going. Were orders increasing or decreasing? Particularly if they do Government business, as many of these electronic firms seem to be engaged in, it is quite important to get that fact, because Government business may or may not continue as a permanent thing. We also inquired if there had been any declines in the rate of new orders. In other words, you might have a substantially good backlog

this year as compared with last year, and yet the rate at which new orders are coming in may be tapering off. So that ought to be pointed up.

Also, you might look at the profit and loss statements, you might have the last fiscal year on an interim period in there. They might show a good rate of profit. The important point is, has that rate of profit continued? One way to find out is to throw something like that at them: If the registrant's current operations are at a materially lower level or show a materially lower trend of profit than is indicated in the most recent financial statement included in the application, the change in operations or operating results should also be discussed under this item.

I have mentioned the idea of the general competitive conditions in the industry and the position of the enterprises in the industry. That ought to be brought out. If you see from an examination of the financial statements that there has been a decline in the trend of net sales, say, or net income, don't hesitate to ask them **why. The** facts should be set forth for such decline in 1955 or 1956.

Another important item is the description of the property. They ought to present full information about the nature of the property, and particularly its productive capacity. Some companies come in and say we can produce ____ dollars of goods in a particular year, or we have been producing goods at a particular rate in terms of dollars. That is no good. What we want are physical units. Dollar figures don't mean much when you have varying prices on the item. What is the physical capacity of the plant, and to what extent is it being utilized? For example, in steel companies they may be operating at 90%. If a company is new, organized within five years, we have an Item 5 that calls for considerable information about the promoters, what the company got from them and what it cost the promoters. In other words, that is more typical of a mining company. You will find that the promoters will wind up with a large block of stock after having turned over perhaps some cow-pasture, or something of that nature to the company. If you do have a new company, just what have the promoters received from it and what have they given in return to the company? That has to be spelled out. It is important if there are any affiliations to find that out as well.

I shall skip over the remuneration item because that is quite similar to the proxy rules and that has been touched upon in another session here.

On the principal holders of securities, information is called for as to 10% stockholders. We find sometimes that some companies have not always been quite frank. They might say there are no 10% stockholders, or name some individuals and say that they individually don't hold any 10% of the stock. Yet you may find some sort of a holding company -- personal holding company -- which does hold a substantial block of stock and the company would fail to point out that these individual officers or **directors happen to have a controlling interest** in that holding company. That type of information ought to be brought out.

Item 14 relates to capital stock being registered. Several things ought to be looked for in examining that item. First, is there cumulative voting? Sometimes you may have to turn to the statute to find out whether or not there is cumulative voting. It may be mandatory under state

law. In other cases you may have to turn to the articles of incorporation, or sometimes even the by-laws, to find out whether or not there is **a provision for cumulative** voting.

The second thing that is sometimes missed is the matter of preemptive rights. There may not be a clear disclosure as to whether or not stockholders have pre-emptive rights to buy any additional shares of the same class of securities to be issued in the future.

A third important point that should be considered there is in connection with dividend rights. In other words, are there any limitations upon the payment of dividends, or any requirements in any bank loan agreements or indentures that working capital be maintained at a certain level. That means taking a look at any exhibits you have, particularly indentures, mortgages, or bank **loan agreements,** and reading them to see whether or not there are such restrictions. If there **are, they** ought to be **spelled** out.

Item 17 relates to recent sales of unregistered securities. The purpose, of course, is to find out if the company has been selling securities and whether or not an exemption was available under the Securities Act of 1933. It is an item you can take up with your group lawyer, but you should secure an adequate disclosure and an adequate statement of the exemption relied upon. It is not enough for them to claim a Section 4(1) exemption, they must go beyond that. Show that it was taken for investment, that a small group of persons was involved, and if it involved some type of stock-option plan, that the type of persons to whom the securities were optioned had a pretty good knowledge of the affairs and operations of the company.

It is quite important that we get all of the exhibits because if we don't get them, the company has an out for not filing any amendments to them in the future. Some of the important exhibits particularly relate to debt. Quite frequently companies seem to think that because they are not registering debt, bonds or debentures, they therefore do not have to file the constituent instruments relating to the debt. The fact is that they do. Quite frequently, the examiner fails to remember that if the amount of debt does not exceed 5% of the total assets of the company, the company does not have to file the indenture but it does have to include an agreement that at the request of the Commission it will submit the particular indentures if we call for them.

Be sure to get copies of all pension and retirement plans. Also, if there are any options, get copies of the stock capital plans, and if you read the instructions carefully, you will note that not only the stock option plans, **but also the option agreements are required to be filed. Also, all the material contracts either for services or purchases of material of an important nature, and particularly contracts with management or supervisory personnel.**

Once a company has filed a Form 10, of course, it has to file annual and current reports, and also the semi-annual reports on 9-K.

Form 8-K is the current report form and is due to be filed on the tenth of the month following the month in which certain events may have occurred. Form 10-K is your annual report filing. Form 10-K has been quite simplified. From the viewpoint of examination, you might say that there is not too much involved. That is really not quite so because the important

thing in examining the 10-K is to find out whether anything has happened which has not been reported in the current report on Form 8-K.

The most significant source of information will be the financial statements themselves. I have seen examiners who thought that because there is a group accountant, they do not have to look at the financial statement. You should look at the financial statements, particularly the notes, and read them rather carefully because they will give you valuable information as to events which may have occurred that should have been reported in current reports on Forms 8-K. For example, there will be disclosures as to options. You may find by comparison of the balance sheet with the balance sheet of one year ago that there may have been increases, or perhaps decreases, in the amount of securities outstanding that should have been reported. You may find limitations upon the **payment** of dividends. The company has negotiated a new **bank loan or some agreement** with an insurance company. That also ought to be spelled out. So the financial statements do serve as a significant clue of things of that nature. There may have been a lawsuit which has not been reported that should have been disclosed in an 8-K under **the litigation item.**

The Form 8-K has really **become** a sort of basic document. It keeps the affairs of the company up to date. When 8-K's are filed, I have found that some items have not been **answered** too well. One of the most important items is Item 2 relating to acquisitions or dispositions of property and assets. That item in **Form** 8-K calls for rather clear disclosure of what was being paid for the assets, form whom it was obtained, whether there was or was not arms-length bargaining in negotiating the deal. If there was not, what were the affiliations of the person from whom the property was acquired with the officers or controlling stockholders of the company. It is important to find that out. Just how did they arrive at the price, for example.

Another item that is missed is Item 4 which relates to modifications of securities. **One** of the most important things there is the imposition of dividend limitations and working capital restrictions. That should be spelled out.

Another item, of course, is Item 7 covering issuance of securities. The company sometimes fails to give adequately the information as to the use of the proceeds from the sale of the securities and also fails to cover adequately a Securities Act exemption claimed, if any.

Form 8-K lists certain exhibits that are called for, and you should check those very carefully. You will note that Form 10-K, if you look at the instructions as to exhibits, ties back to the exhibit requirements of Form 10. That means that if you want to see whether or not any particular exhibit was called **for, you better go back and see what** kind of exhibits would have been **called for if** the company were now filing a Form 10. That is important, too.

MR. LEVY: I have been asked to speak to you upon the assistance which may be gained from financial statements in connection with the examination of annual and other periodic reports.

Let me tell you at the beginning that we think that financial statements are perhaps the most important of these filings. It will be the financial statements that you will use to get a preview of the company that you are examining. It will also give you the character and kind of

business that you are dealing with. Perhaps the best attitude to adopt in examining these annual reports or all of the forms you have here is that you are a stockholder or that you want to make an investment in the business. The best way to get that attitude or to find out the most about the business is to examine the financial statements.

These financial statements in most cases are required to be certified. Again, in most cases they are certified **by national** firms who are very familiar with our rules and regulations. When they prepare these statements, they follow Regulation S-X very, very closely and with great ability. Regulation S-X has numerous requirements as to information that you are required to examine in the annual reports.

Perhaps the most important part of these examinations would be in connection with remuneration, in which the stockholders are most interested and that deals with pension plans. Regulation S-X requires that certain information in respect to pension plans be furnished. So that in connection with your examination, if the information is not there, as to pension plans, you will take a peek in the notes **and see** whether there is any reference there to pension plans. If so, you will have a deficiency.

Another part of your examination has to do with options to purchase securities which is also a very important topic to the stockholder or the person who wants to make an investment in the company's securities. There again, if you see no information as to option plans you will take a peek in the financial statements. If they are certified by a national firm, you may be sure that information in respect to options will be there.

There are certain sections to the financial statements you should observe. These would be the capital stock and surplus section in the balance sheet, the income statement, and the notes to the financial statements.

When you go through the notes to the financial statements you will find there numerous topics and clues as to things that might have been omitted in connection with the answers to the items in the annual report. That is one of the best means of examining these annual reports. If you are not too familiar with the requirements of the items, take the financial statements of a large company as a working model and examine these as to the topics required in connection with these detailed items, and see how they are commented in the items. You will learn just where they are to be found in the financial statements, and you will get familiar with finding the omissions in the item in the filings of companies that have not prepared the statements in line with our requirements.

Mr. Kaufman has commented upon the examination of the 10-K's, in locating events that have not been reported upon in the 8-K Form. The reason for that is that when you examine a Form 10-K filing and you look at the financial statements, especially with the viewpoint of determining whether or not all events have been reported that are required to be reported on Form 8-K, you can observe the value of the financial statements when you see all these events that are required to be reported which can be found, generally in well prepared financial statements certified by the national firms of accountants. Take Item 2 as to the acquisition and disposition of assets. That always is reflected in the financial statements. Then you come across

Item 3, legal proceedings. A good firm of accountants always examines the affairs of a company as to legal proceedings, especially with a viewpoint of determining whether all the contingent liabilities have been described or reflected on the face of the balance sheet. Then Item 4 as to changes of securities. Changes in securities, of course, are caught by a comparison of the capital section of the financial statements previously filed with those currently filed.

Practically a majority of the events required to be reported in the Form 8-K can be found in the examination of the financial statement. So that it can be properly stated that no examination can be complete unless you consult the financial statements and unless you get also an understanding of the financial statements because so many things are required to be reflected and reported upon in the financial statements under our rules. You will find this the best source in connection with your examinations, also the best source of an understanding of the company whose affairs you are examining.

Adjourned.