

LET
1

Speeches S.E.C. Staff

"FUNCTIONS OF THE LISTING SECTION
OF THE
REGISTRATION DIVISION"

SECURITIES AND
EXCHANGE COMMISSION
LIBRARY

ADDRESS

by

ANDREW J. CAVANAUGH,

Assistant Director, Registration Division

Securities and Exchange Commission

Before the S. E. C. Local #5
UNITED FEDERAL WORKERS OF AMERICA

Washington, D. C.
February 28, 1939

42408

You have heard about the registration Division in general and, in particular, about its operation under the Securities Act of 1933. Today I intend to discuss briefly the Securities Exchange Act of 1934, and more particularly the work of the Listing Section of that Division. Time does not permit a detailed exposition of our work, but I hope to leave with you some appreciation of its scope.

To give you a clear picture of the functions of this Section I feel that we should create a little background and approach the subject with an understanding of the 1934 Act.

As you probably know, the preamble to the Securities Exchange Act of 1934 describes it as an Act

"to provide for the regulation of securities exchanges and of over-the-counter markets operating in interstate and foreign commerce and through the mails, to prevent inequitable and unfair practices on such exchanges and markets and for other purposes".

The objectives sought in the passage of the Securities Exchange Act of 1934 were threefold; viz, to prevent the excessive use of credit to finance speculation in securities; to see to it that the market places in which securities are traded were purged of abuses which had crept into them; and to make available to the average investor honest and reliable information sufficiently complete to acquaint him with the current business conditions of various companies, the securities of which he may desire to buy or sell.

I shall not attempt to deal with those aspects of the first named objective which concern the excessive use of credit for speculative purposes, or, in other words, margins and borrowing by brokers and dealers. The control of these avenues and uses of credit was entrusted to the Federal Reserve Board.

To attain the second named objective the Act requires, among other things, that all stock exchanges either be registered, or, if their volume of trading is small in character, that they be specifically exempted. All of the large exchanges and a number of the smaller exchanges filed registration statements with the Commission and are known as National Securities Exchanges. At the present time there are 20 such exchanges, namely:

- Baltimore Stock Exchange
- Board of Trade of the City of Chicago
- Boston Stock Exchange
- Chicago Stock Exchange
- Cincinnati Stock Exchange
- Cleveland Stock Exchange
- Detroit Stock Exchange
- Los Angeles Stock Exchange
- New Orleans Stock Exchange
- New York Stock Exchange
- New York Curb Exchange
- New York Real Estate Securities Exchange, Inc.
- Philadelphia Stock Exchange
- Pittsburgh Stock Exchange
- St. Louis Stock Exchange
- Salt Lake Stock Exchange

San Francisco Stock Exchange
San Francisco Mining Exchange
Standard Stock Exchange of Spokane
Washington Stock Exchange

In addition to the above, the following 7 exchanges are operating as exempt exchanges:

Colorado Springs Stock Exchange
Honolulu Stock Exchange
Milwaukee Grain and Stock Exchange
Minneapolis-St. Paul Stock Exchange
Richmond Stock Exchange
Seattle Stock Exchange
Wheeling Stock Exchange

To accomplish the third named objective the Securities Exchange Act of 1934 requires that any corporation whose securities are listed on a National Securities Exchange shall file, both with the Commission and with the Exchange, a registration statement and shall continue to keep the information regarding its affairs reasonably current by filing annual and current reports designed to show the actual financial condition and position of such corporation.

The exchanges, prior to the passage of the Act and up to the present time, have required as a condition of listing that statements covering the nature of the business of a company, its management, its control and its financial operations must be filed by the company issuing the securities. This principle has, of course, long been in existence, but the detail of the listing statement has varied from exchange to exchange, and in some cases has been a sketchy and valueless document.

It would be useless for us to pretend that corporate reports in the past have always been truthful and revealing, and without adequate corporate disclosures the basis of stable investment is, of course, lacking. The Commission, therefore, being confronted with the task of developing adequate corporate reports from the issuers whose securities are listed on exchanges, adopted and published the following applications to be filed by such issuers:

Form 10 - Application for the permanent registration of securities of corporations except those specifically excluded by the instructions.

Form 11 - Application for unincorporated issuers except those specifically excluded by the instructions.

Form 12 - Application for registration of securities of companies making annual reports under Section 20 of the Interstate Commerce Act or under Section 219 of the Communications Act of 1934, except such companies in receivership or in process of reorganization pursuant to Section 77 of the Bankruptcy Act.

Form 12A- Application for companies in receivership or bankruptcy and making annual reports under Section 20 of the Interstate Commerce Act or under Section 219 of the Communications Act of 1934.

Form 13 - Application for insurance companies other than life and title insurance companies.

Form 14 - Application for Certificates of Deposit Issued by a Committee.

Form 15 - Application for Incorporated Investment Companies.

Form 16 - Application for Voting Trust Certificates and Underlying Securities.

Form 17 = Application for Unincorporated Issuers Engaged Primarily in the business of Investing or Trading in Securities.

(Form 18 = Application for Foreign Governments and Political Subdivisions Thereof.

(

(Form 19 = Application for American Certificates against Foreign Issues and for the Underlying Securities.

(

Foreign (

(Form 20 - Application for Securities other than Bonds of Foreign Issuers (Private Issuers.

(

(Form 21 - Application for Bonds of Foreign Private Issuers.

Form 22 - Application for Issuers Reorganized in Insolvency Proceedings or which have succeeded to a Person in Insolvency Proceedings.

Form 23 - Application for Successor Issuers.

Form 24 - Application for Bank Holding Companies.

These applications for registration were designed with the view of bringing to the investing public adequate information as to the nature and the record of securities listed on the exchanges. The task was to accomplish this result and at the same time to make no demands either from a standpoint of difficulty or of expense to which any corporation that held itself out for public investment could reasonably object. Flexibility was essential, and at the same time definiteness was required so that corporations could clearly understand the obligations that they were required to assume.

In general the forms for original registration call for information of a non-financial nature, as well as financial data. A brief summary of these non-financial questions will illustrate the character of the material required to be furnished. First, a number of simple questions have to do with the organization of the registering corporation and of the system of which it may be an integral part. Next follow a series of questions which outline the capital structure of the registrant, calling for its authorized and

outstanding funded debt; the debt structure of its subsidiaries; the authorized, issued, and outstanding capital stock of the registering corporation; the amount of securities of other corporations that it may have guaranteed; and its position with reference to outstanding warrants and rights. Then follows a series of questions directed toward getting an adequate description of the actual securities being registered, so that there may be a succinct statement of those matters relating to these securities of which any investor should be aware, such as conversion and redemption rights, interest or dividend rates, underlying collateral, substitution rights, and the like.

An effort has been made to confine these questions to elemental facts relating to the issue being registered. To afford investors more detailed and thorough knowledge of such matters, certain exhibits are required to be filed, such as underlying indentures or other constituent instruments defining the rights of the security holders.

There follow a number of questions, one of which seeks information as to recent financing, a series of which relate to the control and management of the corporation, and finally, one question directed towards such stock options as may be outstanding and thus may materially affect the trading position of the securities on the Exchange.

The second portion of the form calls for balance sheets as of the close of the most recent fiscal year and profit and loss statements, together with supporting schedules, for the three years preceding the date of the balance sheet. The rules require that these statements shall contain, as a minimum requirement, the information specified in the instructions. While suggested forms for the presentation of these data are set forth, the rules permit the registrant to file the statements in such form and order and to use such generally accepted terminology as will best indicate their significance and character in the light of the instructions. This should not be interpreted to mean that any information called for by the form may be omitted, if present in the accounts, but only that certain variations in the presentation of the data are permitted.

When the Act first came into operation it was necessary for the Commission, in order not to disrupt the continuity of business on the exchanges, to accord to all securities then listed on exchanges the right of temporary registration. This right, however, expired on July 1, 1935. Prior to that date 1,801 companies filed registration statements with the Commission and 801 companies continued under an exempt status by specific rules of the Commission. Having the basic information with respect to a majority of the companies it was necessary to provide means of making available to the public illuminating and somewhat continuous information. To accomplish this the Commission promulgated the annual reports for corporations, which are required to be filed within 120 days after the close of the fiscal year. These reports bear a related number to the original application (such as Form 10-K), with the letter "K" added to indicate that it is a filing under Section 13, which provides for periodic reports. In addition, a form designated as 8-K was promulgated for the purpose of obtaining current information in respect of certain material changes occurring during the year. This form is required to be filed within ten days after the close of the month in which certain events have occurred.

Three copies of all applications and reports are required to be filed with the Commission, at least one of which must be a duplicate original and manually signed. The copies on file here in Washington are available for inspection in the Public Reference Room. As a further aid to the public in obtaining access to this information filed under the Exchange Act, other copies of the filings of companies not registered on the larger exchanges have been transferred by the Commission to the regional offices in New York and those registered in New York to the regional office in Chicago. And, finally, the investor may purchase at a nominal cost, photostatic copies of all material on file.

Unquestionably these filings are digested by the financial services which publish financial data for the information and guidance of the investing public. By this means any person who contemplates the question of whether he should buy, sell or hold a security listed upon any registered stock exchange, has readily available information more adequate and reliable than any heretofore placed within his reach.

Applications for registration of new securities, additional securities of the same class already registered, or for the registration on an additional exchange are filed daily with the Commission. The largest portion of such applications are filed on Form 8-A, a simplified form for the registration of additional securities on an exchange on which other securities of the registrant are registered. Some are filed on Form 8-B, designed for Securities Issued in Certain Cases upon the Registrant's Succession to an Issuer or Issuers of Previously Registered Securities. Others are filed on the forms previously mentioned for original registration and on Form 8-C, another simple form for registration of securities on an additional exchange. These applications are filed pursuant to Section 12(b) and (c) of the Securities Exchange Act, and while deficiencies are cited, the filing of amendments, unlike delaying amendments under the Securities Act of 1933, has no effect upon the effective date of registration. Section 12(d) of the Exchange Act provides that if the Exchange authorities certify to the Commission that the security has been approved by the Exchange for listing and registration, the registration statement shall become effective thirty days after the receipt of such certification by the Commission, or within such shorter period of time as the Commission may determine.

It is the policy of the Commission not to accelerate the effective date of an application for registration unless the registrant or the exchange on which listing and registration is sought can meet the burden of establishing that: (a) an exchange market in the particular case is not undesirable; (b) the denial of acceleration would seriously embarrass the operation of the exchange mechanism or would seriously prejudice investors, and (c) the need for acceleration could not as a practical matter have been avoided by reasonably prompt action on the part of the registrant.

At the present time there are 2,465 issuers with securities registered on national securities exchanges and 48 issuers with securities traded on an exempt basis. Some idea of the quantity of filings these issuers make under Sections 12 and 13 of the Exchange Act may be obtained from the following figures:

From July 1, 1937 through June 30, 1938 (12 months)

Applications for registration of securities	431
Annual and Current Reports	4,629
Amendments (including a few for Proxy and broker-dealer filings not handled by us)	8,897
Total	13,957

This averages over 40 incoming filings to be handled each working day by our section. Each must be properly recorded, routed to the analyst, assigned to an examiner, a report made and reviewed, letters, deficiency or clearance memoranda prepared in connection with each separate filing, each of which must in turn be properly recorded. With such a quantity of material it is, of course, necessary to have a highly organized unit in order to dispose of each filing as promptly as possible. Consequently you will not be surprised to learn that it is necessary for the Listing Section to have at least nine examining groups, each consisting of an analyst in charge, his secretary, a reviewer and from two to three examiners. To each of these groups there are assigned approximately 300 companies, the filings for which they are responsible. From this it is apparent why it is necessary to establish a quota for each group of from eight to ten annual reports and sometimes four or five applications each week.

All filings are first forwarded from Docket to Mr. Clifton, whose office receives, records, and routes to the proper examining group all filings under Sections 12 and 13 of the Act. Mr. Clifton's office is the focal point through which all filings and correspondence pass, and the records of the Section are there compiled, including a report showing the status of securities listed on exchanges, which, so far as I am aware, is the only complete and authentic list of securities traded on national securities exchanges. I might add with safety that it is the bible used by the Federal Reserve Board to determine whether a security is available for collateral with its member banks. The maintenance of this list is a task in itself. Each month a duplicate list of securities traded on an exchange is forwarded to each exchange. The exchange checks this list against its records, notes changes thereon and returns one copy for our use in comparing and making monthly adjustments in the list.

Mr. Clifton's group also examines all material filed by exempted exchanges under Conditions (3) and (4) of the Commission's exemption order, and registration statements for "when issued" trading, to which I shall refer later.

After a filing is received by a group the analyst in charge refers it to an examiner. In connection with his examination, the examiner obtains additional information from any filings and correspondence pertaining to the issuer that may have been filed under the Securities Act of 1933, the Holding Company Act and such data as may be available in Moody's, Poor's and other financial manuals. After completion of his examination the examiner prepares a report citing all deficiencies noted and refers to such factual material as will facilitate the review, and he comments on any unusual situation in connection with the case.

In the process of examination, sales of securities not registered under the Securities Act of 1933 are referred to an attorney who either indicates that no apparent violation of that Act is involved, seeks additional information from the company, or refers any apparent violation through the Director of the Division to the office of the General Counsel.

The work of the examiner is checked by a reviewer and a proposed memorandum of deficiencies to the company is drafted, after approval by the analyst in charge of the group.

The proposed memoranda of deficiencies from all groups are coordinated and reviewed by Mr. Ramsey on non-financial items and by Mr. Behrens on financial items, subject to my supervision. In addition to the examining groups there are several specialists in accounting and legal matters who are not attached to any examining group but are available to the entire section.

Deficiency memoranda for those companies listed on the New York Stock, the Chicago Stock and New York Curb Exchanges are forwarded direct to the exchanges for transmittal to the registrant, and direct to those companies listed on the other exchanges.

Unfortunately our work does not end with citing deficiencies. In most cases it is necessary to send at least one, and in some instances three, follow-up letters before obtaining complete amendments. In addition, frequent conferences with the accountants and officials of registrants are held to discuss some of the questions raised in our deficiency memoranda. These delays, in my opinion, are due mainly to two reasons, one being the fact that the Act itself does not prescribe a specified time within which amendments shall be filed, and the other that some of the deficiencies call for drastic changes in the statements.

As you probably know, our examination is not confined merely to checking the items to ascertain whether they have been answered, but whether, on the basis of information obtained from other sources, they adequately disclose the information required. Stress is laid upon adequate presentation of results from operations and upon consistency of sound accounting principles, particularly the consistency and uniformity with which the registrant applies such principles in preparing and presenting its financial statements. The examination made of the financial data, which requires imagination, deductive ability and a thorough knowledge of accounting principles, has, I regret to say, brought to light a large number of statements which were not prepared in accordance with sound accounting principles. There are many and varied types of such procedures, but for the most part they involve improper credits to income, credits to earned surplus which should be made to capital surplus, and charges to capital surplus which should be made to earned surplus. Some idea of the incorrect procedures followed may be obtained by referring to the releases of the Chief Accountant which were published as a result of the practices discovered by the Registration Division.

In some cases, because of the failure of registrants to amend properly the statements filed, or otherwise failing to comply with the requirements, it has been necessary for the Commission to institute proceedings under Section 19 (a) (2) of the Securities Exchange Act, which provides:

"After appropriate notice and opportunity for hearing, by order to deny, to suspend the effective date of, to suspend for a period not exceeding twelve months, or to withdraw, the registration of a security if the Commission finds that the issuer of such security has failed to comply with any provision of this title or the rules and regulations thereunder."

or under Section 21 (a) which provides that

"The Commission may, in its discretion make such investigation as it deems necessary to determine whether any person has violated or is about to violate any provision of this title or any rule or regulation thereunder."

Among the well-known companies against which action has been taken are the Missouri-Pacific Railroad Company, Alleghany Corporation, Transamerica Corporation, and Associated Gas & Electric Company.

Another of our duties is the administration of the Commission's rules which require registration of unissued securities before trading in those unissued shares may take place on a national securities exchange. This type of trading is called "When Issued" trading. It derives its name from the fact that the sale and purchase of a security is conditioned upon issuance; i.e., the seller agrees by written contract to sell and deliver and the buyer agrees by written contract to accept and pay for at a stated price (usually, of course, the market value of the security at the time the contracts are made) a stated quantity of a specified security "when, as and if" issued. At the time the security is issued, the price may be higher or lower than the price at which the contract was made, in which case the buyer or seller has made a profit on the transaction.

It is not my purpose to discuss the question as to the economic necessity for when issued trading. I refer to this question only in connection with giving you, briefly, the reason as it seems to me, why, to the uninitiated, the when issued trading rules of the Commission seem rather complicated. It appears that because of alleged abuses connected with when, as and if issued trading in the late '20's and early '30's, there existed strong doubts in the minds of those engaged in drafting stock exchange control laws whether any "when issued" trading should be permitted on exchanges. The net result of all the arguments pro and con is the present law embodied in the last two sentences of Section 12 (d) of the Securities Exchange Act of 1934. Briefly, the first sentence provides that an unissued security may be registered only in accordance with such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors. I think you will gather from the second sentence some idea of the basic reason why our when issued rules seem complicated, for the second sentence imposes a limitation on the authority to make rules, granted under the first sentence, by providing that unissued securities may be registered only in those cases where the unissued security is the right or the subject of a right granted to the holders of a previously registered security, and where the primary purpose of such registration is to distribute such unissued securities to such holders.

While, under such statutory limitation, you may suppose that the number of registration statements for when issued trading on exchanges is not large at any given moment, nevertheless, the orderly disposition of each case involves a great deal of diligence and careful handling on our part to see that the rules have been complied with prior to the institution of when issued trading.

As we scan the results of our operations I think I am not alone in the belief that the evidence indicates that we are realizing the objective of obtaining for the public statements which have been prepared in accordance with sound accounting principles and which accurately reflect the true state of the financial condition and of the accounting practices of the issuer.

---oCo---