Address by

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The nation is grateful for the progress in the exploration and development of mineral resources that has been continuing on the Colorado Plateau during the past few years. The existence of a flourishing mining industry in this area is not only vital to the economic prosperity of the region but also is essential to the security of this country and the free world. Continuous availability of sources of capital to develop new and unseasoned enterprises from individuals who are willing to take the risk of uncertain, speculative investments is an essential ingredient of economic growth.

The raising of venture capital from the public for legitimate mining promotions should, therefore, not be stifled by unnecessary regulatory restrictions. Because mining is basically speculative in nature and the risks of success and the chances of exceptional returns are great, the enormous interest in the development of mineral resources has created serious problems both for the securities industry and this Commission. Irrespective of any legislation or regulatory controls, losses will be suffered by both promoters and investors in mining enterprises.

The mining industry, like other industries, is subject to the Securities Act of 1933 when it attempts to raise funds from the public. Under this Act, the Securities and Exchange Commission has the primary mandate of protecting the public by requiring full and fair disclosure of the character of the securities sold to the public and by preventing fraud in the sale of securities. Under the concepts of full publicity of material facts inherent in the philosophy of the securities acts, the public investor is entitled to certain basic, minimal information about the enterprises to which he contributes his money. Some of these important disclosure requirements include a description of the business, its properties and securities, transactions between the issuing corporation and the promoters, accurate estimates of mineral reserves and mining profit margins, and the effect of stock dilution caused by the issuance of options and warrants to promoters and underwriters. In promotional issues, the Commission also requires the issuer to state prominently on the cover page or at the beginning of the prospectus or offering circular the speculative nature of the enterprise.

The Congress has permitted, and the Commission has by its rules implemented, simplified procedures for raising a limited amount of capital from the public. If the aggregate offering price of an issue does not exceed $300,000, the issue may not be subject to the full registration requirements of the Act but the terms and conditions prescribed in our Regulation A rules must be complied with. The number of filings under Regulation A in the Denver Office of the Commission during

the calendar year 1954 totalled 338 for a gross aggregate offering price of over 59 million dollars. From January to the middle of November 1955, the number of filings increased to 427 for a gross aggregate offering price of more than 92 million dollars. During the summer months of this year, which was the height of the uranium boom, the Denver filings averaged 51 per month. The number of Denver filings decreased during the month of October 1955, to 20.

Our administrative task in processing Regulation A filings is two-fold. First, in its letters of comment the Commission assists issuers to comply with reasonable disclosure standards in the preparation of the offering circular. The responsibility for the accuracy and completeness of the information filed with the Commission, however, rests solely on the issuer and underwriter. Secondly, if the staff has reason to believe that a filing is tainted with fraud or has been prepared in a grossly inadequate manner, or if the exemption is not available to the issuer, the Commission issues an order denying or suspending the exemption. Cases involving fraud are referred to the Department of Justice for criminal prosecution. Of the 33 orders issued by the Commission since June 1 through November 15, 1955, denying or suspending the Regulation A exemption, 10 have been made against the issues filed in the Denver Office.

Due to the intensity of the public speculative interest in uranium, the evils of high-pressure salesmanship has sometimes occurred in the distribution of the stock of small mining companies. In some instances, Regulation A has been used for purely stock-jobbing purposes. Offerings have been withdrawn as soon as sufficient securities have been sold to pay the claims of promoters and the commissions and expenses of underwriters. The insiders walk away from the deal and the public investor is left with a worthless equity in a company without operating funds. Other promotional issues have been heavily weighted against the public investor, who has furnished all the cash capital, through the issuance of warrants and options to promoters and underwriters. Sometimes, the underwriters have received more than a third of the total gross proceeds from the public distribution in commissions and expenses.

Public investors will continue to show confidence in the mining industry by contributing capital t enterprises only if the promoters and broker-dealers treat them fairly. Existence of over-reaching or fraud on the part of promoters or underwriters inevitably injures the entire mining and securities industry in this region as well as the persons and companies particularly involved.

The Commission has attempted to protect the public from front-money rackets and stock-jobbing activities in various ways, such as by requiring adequate disclosure, denying or suspending offerings, investigating and prosecuting fraud, and regulating the practices of broker-dealers. In addition, the Commission has proposed certain stiffer requirements for the use of Regulation A by promotional companies.

On July 18, 1955, the Commission circulated for comment its proposed Regulation A revisions, and on November 15, 1955, public hearings on the proposals were held in Washington. Numerous written comments were elicited from lawyers, issuers, broker-dealers, accountants, newspapers, stock exchanges and state securities administrators. Considerable interest in the proposed new rules was also shown during the hearings on the bill of Congressman Bennett to abolish the conditional exemption under Regulation A, which were recently held in Denver, Salt Lake City and New York City. All of these observations are being given careful consideration by the Commission.

In deciding whether to adopt the proposed rule revision, in whole or in part, or whether the public interest would be best served by requiring promotional companies to register their securities under the Securities Act, the Commission has first to surmount the hurdle of determining the permissible scope of the statutory exemptive provision. Section 3(b) of the Act says, in part, that the Commission may exempt any class of securities "if it finds that the enforcement of . . . . /the registration requirements/ with respect to such securities is not necessary in the public interest and for the protection of investors by reason of the small amount involved or the limited character of the public offering. . ." The statute provides further that the aggregate amount of an exempt public offering shall not exceed $300,000.

When the amount of a public offering is small and of limited character - and by statutory definition "small" means less than $300,000 - the Commission has the authority to exempt the issue from the requirements of registration and prescribe terms and conditions for making the offering provided that it makes the finding that the public investors do not need the protections afforded by full registration. The protections of full registration include the right to recover damages for false or misleading statements or omissions against the persons signing or named in the registration statement. In allowing the conditional exemption from registration, Congress intended to encourage the development of small business by making the procedures for raising a limited amount of capital from the public relatively simpler and less costly than in raising large sums. One factor in making small financings less complicated and less expensive was the elimination of the protection afforded by the civil liabilities of the directors, experts and underwriters to investors.

The question arises whether the Congress contemplated that the conditional exemption should be extended to promotional companies in speculative industries where, by reason of inherent economic hazards, investors are not protected from extreme risks of loss. A forceful argument can be made that the public interest is not being best served by making the exemption available to speculative classes of securities where the public investor is liable to suffer severe losses. If the likelihood of losses exists - even losses occurring from economic

factors - it can be argued that the public investor should not be denied the protection afforded by the civil liabilities section. On the other hand, the design of the Congress in permitting the exemption was to facilitate the financing of small businesses by simplifying the requirements for offering their securities to the public. The companies that need the benefits of the exemption from registration most are promotional enterprises whose public offerings of securities are small and of limited character.

The Commission is facing the problem of whether it is in the public interest, and within the intent of Congress, to continue to allow the use of the exemption by promotional companies. The economic advantage that results from facilitating the financings of small companies must be balanced against the possible loss of investor protection where exemption from full registration, with its attendant provisions for civil liabilities, is permitted. If the Commission determines to retain the conditional exemption for small promotional issues, instead of putting these offerings under registration requirements, it does not intend to adopt revisions to the Regulation A rules that may be unduly restrictive on the issuers.

Examination of the documents required to be filed under Regulation A by the Regional offices of the Commission has been an essential component of our enforcement program to detect and prevent fraud in the sale of securities. Another important method used by the Commission in protecting the public investor is its broker-dealer inspection program. Brokers and dealers registered with the Commission are subjected to periodic, surprise inspections by our investigators. The financial condition of the firm is ascertained, and the practices as to pricing, treatment of customers' funds and securities and making proper disclosures to customers are reviewed. The adequacy of the firm's procedures in keeping the books and records prescribed by the Commission is also carefully studied. While our inspectors make every effort to avoid unnecessary disruption of the business of the firm, they do a thorough job. If the inspection report discloses that the capital of the firm is impaired or if other serious violations are discovered, prompt action is taken to revoke the registration or enjoin the unlawful practices.

The high volume of financings by small promotional companies has attracted a vast number of newcomers into the securities business. This rapid growth of registrants has raised serious problems for the Commission in carrying out its responsibilities to protect the public. On June 30, 1953 there were 62 registered broker-dealers in Colorado and 28 in Utah. Two years later, Colorado had 106 and Utah had 85; the broker-dealer population in these two states alone had increased in two years from 90 to 191. This increase was approximately one-third of the total increase in the number of broker-dealers in the entire United States for these two years. During the same period the NASD members in the two states increased from 57 to 130. Many of these new registrants have had no background of financial experience and they often contributed insufficient capital to their businesses.

In order to ascertain whether these brokers and dealers were conducting their affairs in a lawful manner, the Commission recently dispatched a special inspection task force to the Denver-Salt Lake area. From August to the middle of November, the task force completed a total of 50 inspections. Based upon its reports, three firms have been enjoined from doing business by reason of insolvency and violations of the net capital rule and revocation proceedings have been recommended to the Commission against two other firms. In addition, several registrants have applied for withdrawal of their registrations as a result of the disclosure by the inspections of capital and other deficiencies. We have sent warning letters to many of the other firms which have been inspected, citing various deficiencies in their operations which did not warrant initiation of disciplinary proceedings, as where the violations were relatively minor and resulted from inexperience.

The task force has inspected several NASD member firms in this region which were recently inspected by the NASD. Duplication of inspections was necessary, in spite of the arrangement between NASD and the Commission designed to avoid frequent revisitations of firms, because of the large number of new, inexperienced registrants and indications of unsound financial condition of some of them. The Commission has the duty to make inspections, which cannot be delegated to the NASD, for the enforcement of its own laws to protect the public investors, and the NASD has a similar responsibility to obtain compliance with its own rules. Our inspectors, being experienced men in the securities field, assist registrants by explaining the use and purposes of the various prescribed records and offering constructive suggestions. On the other hand, the inspectors do not hesitate to recommend action - as injunctive or revocation proceedings - against firms where violations injure the public interest.

The high level of the securities markets has made it advisable for the Commission to provide new safeguards to protect the public against broker-dealer insolvencies that could be caused by possible market declines. The net capital rule applicable to broker-dealers has been tightened to provide that in computing net capital a 30% deduction from the market value of common stock commitments or inventory must be made. This so-called "haircut" of 30%, as compared with the former 10% deduction, establishes a more stringent standard for broker-dealer financial responsibility.

The coverage of the net capital rule has, by a further rule amendment, effective December 1, 1955, been extended to substantially all broker-dealers registered with the Commission regardless of whether they carry customers' balances or securities. Approximately 40% of the broker-dealers registered with the Commission claim that they do not engage in the practice of extending credit to customers or carrying money or securities for the account of customers. However, since these broker-dealers frequently owe money or securities to customers in substantial amounts, the Commission believes that their customers

require and are entitled to the protection afforded by the net capital rule.

The Commission is also considering the adoption of a rule that would require all registered brokers and dealers to file annually with the Commission financial reports which have been certified by independent public accountants. At the present time, only broker-dealers who make a practice of extending credit to, or holding securities for, customers have been required to file certified financials with the Commission. The adoption of this new rule in the immediate future, to make it mandatory for all brokers and dealers to file annually certified financial reports, will place additional responsibilities on the securities industry for policing itself and will afford increased protection to public investors.

During the last session of the Congress, Senator J. William Fulbright introduced a bill designed to extend certain provisions of the Securities Exchange Act applicable only to companies listed on national securities exchanges to certain unlisted companies. A similar bill was also introduced in the House of Representatives by Congressman Arthur G. Klein. The Fulbright-Klein proposals apply to unlisted companies having total assets of more than two million dollars if the number of holders of equity securities exceeds 750 or the total amount of debt securities exceeds one million dollars. These unlisted companies would be required to comply with the reporting, proxy and insider trading provisions of the Act.

While recognizing the soundness of its broad principles and objectives, the Commission has not endorsed the Fulbright-Klein bill. The Commission believes that a thorough, objective study of the reporting and proxy practices of the companies affected by the legislation should first be made in order to determine the factual need for such a vast extension of its regulatory jurisdiction. The Commission is presently conducting a survey to ascertain the identities of these companies, the nature of their financial reports to shareholders and their practices in soliciting proxies. The impact of the insider trading restrictions on the sponsorship of their securities by brokers and dealers who are also directors of the companies is also being studied. This analysis, which we plan to complete by the time the Congress reconvenes in January, should disclose whether, in fact, there exist serious abuses that should be rectified by the proposed legislation.

This period of strenuous activity in the securities markets requires the utmost vigilance of the Commission. In carrying out its Congressional mandate, the primary objective of the Commission is to protect the public investors through aggressive and strict enforcement of the disclosure and anti-fraud provisions of the statutes without stifling or strangling the economic development of legitimate enterprises by unnecessary or burdensome regulation. We trust that our work will continue to contribute effectively to investor confidence in the expansion of our economy and the existence of free and open securities markets.

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