VIRGINIA SECURITIES ACT

Report of the

COMMISSION ON ISSUANCE AND SALE OF SECURITIES

To

The Governor

And

The General Assembly of Virginia

Senate Document No. 29

Department of Purchases and Supply
Richmond, Virginia
1974

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to

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Richmond, Virginia
March 1, 1974

To: HONORABLE MILLS E. GODWIN, JR. *Governor of Virginia*

and

THE GENERAL ASSEMBLY OF VIRGINIA

There came to the attention of members of the General Assembly certain instances of burdensome losses incurred by citizens of Virginia by reason of the purchase of securities sold to the public after having been issued improvidently or with the intent to defraud. It was not known whether such occurrences were widespread, but there was apprehension as to the adequacy of the security laws and regulatory functions of the State in regard to the issuance of securities for sale to the public.

This and the related problems discussed below led the General Assembly, at its 1972 regular session, to adopt Senate Joint Resolution No. 25 creating a Commission to study and make recommendations on the subject. This resolution follows:

SENATE JOINT RESOLUTION NO. 25

Creating a Commission to Study the Regulation of the Issuance of Certain Securities.

Whereas, for many years the State has been exercising certain regulatory functions in regard to the issuance of securities for sale to the public; and

Whereas, such securities, if approved for issuance by the State Corporation Commission, may be advertised and sold upon the basis, among others, that they have been approved by the State Corporation Commission, when, in fact, the worth and underlying value of a particular security may not have been investigated in the depth required to protect the investing public; and

Whereas, many members of the public have a bona fide belief that the approval by the State Corporation Commission of the issuance of a security constitutes in effect a guarantee by the State that the investment is a safe and sound one, when such is not the case; and

Whereas, it has been many years since an investigation and study has been made of the effectiveness of the regulation of the issuance and sale of securities by the State Corporation Commission; now, therefore, be it

Resolved by the Senate, the House of Delegates concurring, That a Commission on the Issuance and Sale of Securities is hereby created. The Commission shall consist of eleven members, five of whom shall be appointed by the Speaker of the House of Delegates from the membership thereof, three of whom shall be appointed from the Senate by the

Committee on Privileges and Elections thereof, and three of whom shall be appointed by the Governor from the State at large. Appointees to the Commission shall, insofar as is practicable, be individuals with broad business experience and knowledge of the technical financial operations of corporations, trusts, partnerships and other business entities which seek to raise capital funds from the public. All agencies of the State shall assist the Commission in its work. The Commission shall consider practices in Virginia and in other states in the regulation of the issuance and sale of securities and shall determine what practices of the Securities Exchange Commission of the United States might best be adapted for use in Virginia. The Commission shall conclude its study and make its report to the Governor and the General Assembly no later than October one, nineteen hundred seventy-three. The members of the Commission shall be reimbursed for their necessary expenses incurred in the performance of their duties, for which, and for such secretarial and technical assistance as may be required, there is hereby appropriated the sum of fifteen thousand dollars to be paid from the contingent fund of the General Assembly.

Pursuant to this resolution, the President of the Senate appointed to the Commission from the membership of the Senate the following: Elmon T. Gray, Edward M. Holland and J. Harry Michael, Jr.; the Speaker of the House of Delegates appointed to the Commission from the membership of the House the following: William M. Dudley, Dudley J. Emick, Jr., Frank E. Mann, C. Hardaway Marks and John C. Towler; and the Governor appointed to the Commission Bert Ely, Financial Consultant of Salem, W. Gibson Harris, Attorney at law of Richmond, and Walter H. Steel, retired financial consultant of Kilmarnock.

The Commission, at its organization meeting, elected Senator J. Harry Michael, Jr., Chairman.

The Division of Legislative Services made staff and facilities available to carry out this study. Assigned to assist the Commission in carrying out its directives were Courtney R. Frazier and L. Willis Robertson, Jr.

The Commission met several times and held two hearings. At the first, representatives of the securities industry selected from various parts of the State were invited to appear. Mr. John C. Hagan, III, of Craigie-Mason-Hagan, Inc. of Richmond, appeared on behalf of the member firms of the Securities Industry Association, headquartered in the Commonwealth of Virginia. There also appeared Mr. John W. Riely, Attorney at law of Hunton, Williams, Gay & Gibson of Richmond, Mr. William F. Calliott of Investment Corporation of Virginia of Norfolk, Mr. John L. McElroy, Jr., and Mr. James B. Farinholt of Wheat First Securities, Inc. with offices in several Virginia cities, and Mr. Philip L. Strader, an underwriter specializing in municipal bonds, of Lynchburg. Each of these representatives gave a presentation incorporating their recommendations. Under questioning, they gave the benefit of their advice and experience.

At the second hearing, persons selected from the files of the Division of Securities and Retail Franchising of the State Corporation Commission, who had suffered losses as the result of the purchase of worthless securities, were invited to attend. As a result of the testimony of Mr. William N. Bracey and Mr. James H. Wells, both of South Hill, the Commission was able to follow the history of the losses connected with Regency Manor International Corporation. Mr. Michael S. Hollis of Richmond explained the circumstances relating to Teen Scene U.S.A., Inc.

Mr. Lewis W. Brothers, Director of the Division of Securities and Retail Franchising of the State Corporation Commission, and members of his staff Mr. Robert G. Lewis and Mr. Donald Martin attended the hearings and several meetings of the Commission. Their advice, assistance and recommendations were of great value to the study.

Mr. Toy D. Savage, Jr., of Willcox, Savage, Lawrence, Dickson & Spindle of Norfolk was engaged as counsel for the Commission. He attended all of its meetings, except the first, and assisted with the proceedings of the Commission.

FINDINGS

There appears to be no crisis in the regulation of the issuance and sale of securities in Virginia. Taking into account the high degree of activity in the securities field in the past decade, the reported complaints of fraud or unlawful conduct have been remarkably few in number. Virginia has not been a good market for "lots in the Blue Sky."

THE LAW

Statutes regulating the issuance and sale of securities must be flexible in their application and their provisions are usually couched in general rather than specific language. For this reason, the administrative climate is more controlling in practice than the law.

Virginia adopted its first major legislation in the Blue Sky field in 1918. In connection with its recodification of the statutes relating to corporations in 1956, Virginia was one of the first states to adopt the format of the Uniform Securities Act. All fifty states and the District of Columbia have statutes regulating the sale of securities. Although there are substantial differences among them, the laws of Virginia are generally in the beaten path.

There is federal regulation of the sale of securities also, but the purpose behind the federal and state registration requirements differs markedly. The federal act of 1933, on the one hand, aims primarily at full disclosure. It requires the issuer to give the investing public complete and truthful information about the securities being offered. If that is done, the securities are entitled to be registered, no matter how speculative they may be. The Virginia Securities Act and other similar state statutes have a dual purpose. The Virginia statute is designed to require a full disclosure and also to prevent the fraudulent offering or sale of securities. Complete disclosure, while important, does not automatically result in registration. The Commission may deny registration or issue a stop order denying effectiveness to or revoking the effectiveness of a registration statement if it finds that it is in the public interest *and* that the offering has or will work a fraud upon investors.

Certain state statutes are broader than those of Virginia in that they provide for a denial of registration if the offering is not fair and equitable. It is not thought that the "fair and equitable" approach is necessary or desirable in Virginia for either the statutory or administrative policy. It is the best interest of the economy that the door to the marketplace be open to new businesses and other speculative issues where there is a full disclosure. Usually the question of price of an issue can be left to the judgment of an experienced and stable underwriter willing to purchase the issue for resale. In other circumstances where limits of reasonableness in price or other conditions are reached or exceeded so as to tend toward fraud, the force of the statutes can be brought to bear to deny or stop registration or to condition registration upon the provision of safeguards, such as the escrow of securities or the impoundment of funds.

Section 13.1-510(h) provides that, in a registration by qualification if as much as 25% of the stock of the issuer be issued for an intangible asset (e. g., a copyright or promotional fee), the Commission may require that such securities be held in escrow until the company has earned and paid to its stockholders a dividend of 5% of the initial offering price. While the issuers are not required to demonstrate "fairness" under the Virginia statute, a broader provision granting the Commission discretion in requiring the escrow of "promotion stock," "cheap stock" or stock options would allow the Commission to assure that no fraud would be perpetrated and, at the same time, allow the marketplace to evaluate the worth of such intangible assets for which stock was issued.

In general, the Virginia Securities Act is found to be adequate and satisfactory. There are, however, a number of modifications for modernization and improvement recommended by representatives of the securities industry and members of the staff of the State Corporation Commission and counsel for this Commission, which are thought to be desirable and which are recommended below.

ADMINISTRATION

By the very nature of things, the securities' field is peculiarly one of government by men rather than by law. In an article written for the VIRGINIA LAW REVIEW in 1959, Mr. John W. Riely said as follows:

> "The regulation of the issuance and sale of securities is a delicate matter. The business is such as not to brook delay. Markets fluctuate widely within short periods of time. A security that may be sold today may be impossible to sell tomorrow because of the changed market conditions. Time does not permit judicial review of the right to sell a security; by the time that review is obtained the security will not be marketable."

Underwriters, attorneys and complainants alike praised the administration and administrators of the Virginia Securities Act. The Division of Securities was commended "for the excellent service which they provide and have provided to the public, investors and members of the securities industry who serve those investors. The Commonwealth has indeed been fortunate to have attracted the high caliber of talent we now have and have had in the past serving in these important roles."

A statistical summary of the work of the Division of Securities, generally covering the period January 1, 1971, through November 30, 1972, is attached hereto as APPENDIX A. The Division is handling a large volume of work with a relatively small staff and at small cost to the Commonwealth.

A. *Unlawful Practices.*

In the fraud area, investigations could be made more promptly and in greater depth if the number of experienced investigators was increased. As time is of the essence in the issuance and sale of securities, it is also important in the restraint of unlawful practices. It is recognized that irreparable harm is done to a security issuer if injunctive proceedings and other restraining action is instituted without justification. Nevertheless, the State Corporation Commission should be in a position to move expeditiously when there is a reasonable apprehension of fraudulent conduct. Action should be prompt if an issuer or broker-dealer exhibits a "badge of fraud" such as a delay in the furnishing of requested data or a refusal to allow the inspection of records.

After the completion of investigations, difficulty has been experienced in obtaining indictments and prosecution of offenders. The regulation of the sale of securities is a highly specialized field of law. It would be extremely helpful to local commonwealth attorneys to have available through the office of the Attorney General expert assistance in this area.

The Virginia Crime Commission made a recommendation for voluntary assistance to local commonwealth attorneys from the office of the Attorney General in general criminal matters. This recommendation was incorporated in House Bill No. 302 of the 1972 regular session. That bill failed to pass. If such a bill should be enacted, it would accomplish the desired purpose in this field. It may be that legislation limited to securities law and providing for assistance only upon request of the commonwealth attorney would be less controversial.

It would have a salutary effect if Virginia became known as a State in which those who violate the security laws are promptly investigated, indicted and prosecuted. In order to achieve this objective, it is necessary to have a close

relationship and cooperative effort among the State Corporation Commission, the Attorney General, and the Attorney for the Commonwealth.

B. *Broker-Dealers and Agents.*

The staff of the Division of Securities has difficulty in making thorough and timely audits of all broker-dealers in Virginia. Broker-dealers, doing an interstate business and who are members of the NASD and National Security Exchanges, are thoroughly investigated by independent certified public accountants, auditors of the Securities and Exchange Commission, the National Association of Security Dealers and the New York Stock Exchange or other stock exchanges. They may be audited more than is necessary. If copies of those reports and audits were furnished to the Commission for review, State investigators would have less difficulty in covering adequately intrastate broker-dealers who were not otherwise so audited.

If an individual agent is employed by more than one broker-dealer, legal and practical enforcement problems are presented when a violation occurs. This practice should be prohibited.

Investment advisors have been on the scene for a long time, but in the last two or three years, their number has greatly increased. They are now in vogue and have made a significant penetration of the market. Section 13.1-503 prohibits fraud in the giving of investment advice and renders void investment advice contracts which provide for compensation on the basis of a share of capital gains or capital appreciation of the fund. Although larger and more sophisticated investors are usually the customers of investment advisors, the business is a proper subject of regulation in order to assure that those engaged in it have suitable qualifications. Federal law provides for registration of investment advisors. There should be provision in the Virginia Blue Sky Laws for the registration of investment advisors parallel to that of broker-dealers and agents.

C. *Registration of Securities.*

In the registration area, the volume of work is quite substantial and the responsibility of the Director of the Securities Division and his primary assistants is great. In view of the absence of any practical opportunity for appeal from a decision of the Director, it is usually final. It is important, therefore, that there continue to be men qualified by experience and judgment to deal with questions of a highly sophisticated nature in such a manner as to protect the public and at the same time not unduly impede commerce. The job classification and compensation for these positions should be upgraded to the end that such personnel can be retained for the present and attracted in the future, because without them the required quality of administration is endangered and the investigation process and enforcement proceedings cannot be sufficiently expeditious.

D. *Exemptions.*

In the field of exemption from registration, there appears to be a problem with § 13.1-415(a)(9), which provides an exemption for the securities of non-profit religious, educational, benevolent, charitable, fraternal, social, athletic or reformatory organizations. The initial inquiry, of course, is whether it is desirable to require registration by such issuers. Any answer to that question would be controversial, but even if it be in the affirmative, it would not be practical to remove the exemption without additional substantial amendments. The provisions of the Blue Sky Laws dealing with registration (e. g., those relating to profits, dividends, etc.) would be inapplicable to securities of such non-profit organizations. As a consequence, this subject was felt to be beyond the scope of this study and no recommendation with respect to it will be made here. However, a comprehensive evaluation would be very much in order.

The Virginia exemption with respect to private offerings is in line with that of most states, but is not entirely satisfactory. The existing exemption sets a fixed standard based on the number of security holders of the issuer. Other approaches relate to the number of offenders or the number of purchasers of the security within a period of time or require that the purchaser be knowledgeable and experienced in business matters.

The Securities Exchange Commission has released proposed Rule 146 dealing with the subject which places emphasis on the sophistication of the purchasers. At such time as that rule has been made applicable in its final form, conformity by Virginia would be desirable. At the final meeting of the Commission it was suggested that the Virginia private offering rule be conformed prospectively to the federal rule in the form it may finally take. In the absence of an opportunity to investigate the ramifications of such suggestion, it was decided not to make it a recommendation of the Commission. Nevertheless, the concept of federal-state conformity in the private offering exemption area was thought to have much merit.

RECOMMENDATIONS

Based upon the foregoing findings, the Commission respectfully makes the following specific recommendations.

A. Unlawful Practices.

1. The office of the Attorney General should be authorized by statute to provide assistance to any commonwealth attorney of Virginia, upon request, in obtaining indictments for and prosecution of violation of the securities laws. An adequate staff for this purpose should be provided to the office of the Attorney General.

B. Broker-dealer Provisions.

1. Dual licensing of agents for broker-dealers should be prohibited. Section 13.1-504(b) provides that "More than one broker-dealer or issuer may employ the same agent." That provision should be eliminated.

2. Provision should be made for the registration and regulation of investment advisors.

3. It would be of administrative assistance to the Securities Division if the renewal dates of registration of broker-dealers and agents were staggered so that all registrations did not expire on the same date. Section 13.1-505(d) should be amended so as to allow staggered renewal dates.

4. A new Code section numbered 13.1-518.1 should be enacted so as to require that copies of reports made by broker-dealers and reports of audits by the National Association of Security Dealers, the Securities and Exchange Commission and any national stock exchange be filed promptly with the State Corporation Commission.

C. Registration.

The provisions of § 13.1-510(h) with respect to impoundment of funds and the escrow of securities in certain limited types of situations should be amended so as to allow the Commission, in its discretion, to require such impoundment or escrow as a condition to registration by qualification in broader categories of circumstances.

D. Exemptions.

1. The provisions of § 13.1-514(a)(8), dealing with the exemption of securities listed on certain stock exchanges, should be amended so as to eliminate a defunct exchange now listed and provide for exemption for securities listed on any exchange registered with the United States Securities

and Exchange Commission and approved by regulation of the State Corporation Commission.

A draft of the legislation necessary to implement the foregoing recommendations is attached hereto as APPENDIX B.

ACKNOWLEDGMENTS

Sincere thanks are expressed to all those who assisted the Commission in its work. Our Commission is indebted to its members for their contribution of time, interest and knowledge to the completion of the study. The assistance of Lewis W. Brothers, Jr., Director of the Division of Securities and Retail Franchising of the State Corporation Commission, was of special value and is gratefully acknowledged.

A special thanks is expressed to Mr. Toy D. Savage, Jr. who acted as counsel to the Commission. The expertise which he brought to the Commission was essential to the work of the Commission. His guiding hand helped the Commission to keep the purpose of its work in mind at all times during the study. Once again, the Commission expresses its thanks for the excellent work which Mr. Savage did on behalf of the Commission.

Respectfully submitted,

J. Harry Michael, Jr., *Chairman*

William M. Dudley

Bert Ely*

Dudley J. Emick, Jr.

Elmon T. Gray

W. Gibson Harris

Edward M. Holland

Frank E. Mann

C. Hardaway Marks

Walter H. Steel

John C. Towler

* Mr. Ely dissents from this report in certain specifics. (See p. 8)

DISSENT BY BERT ELY TO THE REPORT SUBMITTED BY THE COMMISSION ON ISSUANCE AND SALE OF SECURITIES

While I am in agreement with the recommendations contained in the Securities Study Commission report, I do believe it should have made recommendations in several areas that it discussed, but declined to make legislative proposals. In addition, several critical aspects of the Securities Act were not commented on at all. Set out below are my specific comments.

REGISTRATION BY NOTIFICATION (§13.1-508)

Registration by Notification allows a Virginia corporation to sell its own securities on an intrastate basis upon notification (by the filing of a registration statement) to the State Corporation Commission (SCC) that it plans to do so, provided it meets certain tests as to its length of time in business, amount of assets and net worth, and other financial measures. Basically, if a company meets this test of longevity and size, its securities automatically become registered. Furthermore, a company issuing securities under this section of the Code is not required to distribute a prospectus, offering circular or other disclosure document when selling its securities.

Under an administratively-set policy, the SCC does ask potential issuers under this section to submit for prior approval any offering circular that will be used in conjunction with the sale of securities. Almost all issuers comply with this request; however, they do not have to submit all the exhibits in support of the registration statement that are required under the Registration by Qualification section of the Code (§13.1-510), nor do they have to waive the requirement that the SCC must approve or reject the registration statement in two days, which waiver the SCC usually requests in order to have enough time to properly review the registration statement and offering circular.

Thus, while the SCC has tried, administratively, to lessen the weaknesses of this section, companies able to qualify under this section are not subject to the more stringent and necessary requirements and review of the Qualification section.

It should be remembered that a multi-million dollar loss to Virginia investors resulted from worthless securities issued under the Notification section. That loss was also a key prompter to the formation of this study commission and is sufficient evidence of the weakness of the Notification section.

RECOMMENDATION: That §13.1-508, Registration by Notification, of the Code of Virginia be repealed so that all intrastate securities offerings must be registered under the Qualification section. This should not work a hardship on potential users of the Notification section since they already have to supply at least some of the information required by the Qualification section. The additional requirements of the Qualification section would enable the SCC to more competently review proposed securities issues. This in turn would result in fuller disclosure to potential investors, which is in the public good.

Based on 1971 and 1972 statistics, the elimination of the Notification section should not materially increase the SCC's workload. For the period January 1, 1971 to November 30, 1972, there were only 38 registrations filed under the Notification section, compared with 90 filed under the Qualification section, and 2121 filed under the Coordination section, §13.1-509, which is used for registering interstate securities offerings that are also registered with the Securities and Exchange Commission (SEC).

If the General Assembly does not wish to repeal the Notification section, then it should at least amend it to incorporate into the law the safeguards the SCC has tried to establish administratively. At a minimum, the word "insurer" in line 7 of §13.1-508(a)(1) should be corrected to read "issuer".

ESCROW AND IMPOUNDMENT (§13.1-510(h))

The twin concepts of escrowing securities owned by certain individuals and impounding funds being raised in a public securities offering are discussed briefly on page 3 of the draft of the report. On page 6 of the draft, a general legislative recommendation is put forth, but no specific legislation is offered.

ESCROW

As is hinted at on page 3, the pricing of securities issues is a continual bone of contention between the SCC and securities underwriters. Administratively, the SCC prohibits excessive stockholders' equity dilution arising out of the issuance of new securities. Until recently the SCC did not allow the issuance of additional stock where the tangible book value of all shares of stock outstanding, after the sale of the additional stock, would be less than one third or one fourth the selling price of the additional stock. More recently, the SCC has eased its maximum dilution limits. In some cases, this dilution test holds down the offering price of the stock of a new company, where no price history or market exists for its stock, and thus prevents a company from fully capitalizing on its earnings potential, good will, etc. Thus, the concepts of escrowing and impoundment are looked upon as an alternative to the present situation whereby the SCC second guesses experienced underwriters as to a stock's offering price and dilution impact. Escrow and impoundment also offer the potential for greater investor protection than does the dilution test.

The escrowing concept, briefly, prevents existing stockholders from selling their securities for a period of time after registered securities have been sold to new investors, particularly in situations where a substantial portion of the company's assets are intangibles such as patents, copyrights, goodwill, organization expenses, deferred costs, etc. With escrowing, the initial investors would not be able to sell their stock shortly after issuing new securities and thus leave the new investors with a collection of intangible assets of doubtful liquidity or realizable value. The report suggests that the existing law, which applies only to registrations under the Qualification section, be broadened to allow the SCC "broader categories of circumstances" in which it could require escrowing.

I believe that the report should have gone further and recommended specific guidelines to incorporate into the law. I am setting out, for purposes of a starting point, my thoughts on specific escrowing guidelines:

-What securities get escrowed. The law now only specifies that securities issued for intangible assets may be escrowed. It does not permit escrowing all the stock owned by certain individuals, no matter what they invested in the company. The SCC should have the power to require the escrowing of all, or part, of the securities held by certain types of individuals-founders, directors, officers, insiders, a majority stockholder, etc. -no matter what was exchanged for those securities and irregardless of whether or not those securities are being registered at that time. Such an approach would help to lock into the company certain key individuals that the new investors are betting on as much as they are betting on the company.

-In what circumstances to escrow. The law now states that escrowing is permissible when "any of the securities sought to be registered by qualification" or at least "25% of any class of the securities of the issuer" that will be outstanding after the issuance of the proposed securities "shall have been or shall be intended to be issued" for any intangible assets. This aspect of escrowing appears to be acceptable, except, perhaps that the percentage, now 25%, should be lowered to 20% or even 10%.

-Releasing the escrowed securities. At present, the law states that

escrowed securities can be withdrawn from escrow as soon as "all other stockholders who have paid for their stock in cash shall have been paid a dividend or dividends aggregating not less tha 5% of the initial offering price". Such dividends are to have been paid out of the earnings of the company. Young, fast growing companies are usually in need of cash and so should not have to be forced to meet a cash dividends requirement in order that securities can be released from escrow. Instead, an earnings test, which would not be a cash drain on the company, should be applied. I would recommend that no stock be released from escrow until the company's operations have at least broken even, cumulatively, since the time the securities were escrowed. This would guarantee that no stock would be sold as long as the book value of the new investors' initial investment had been impaired. Possibly, a positive earnings test, as versus a breakeven test, should be established or, possibly, the SCC should be given the power to set an earnings test on a case-by-case basis.

Right now, there is no minimum time for stock to be escrowed. In order to prevent quick "manufactured" earnings, which would trigger the release from escrow, two years should be set as the minimum period of time stock should be escrowed. A maximum of four or five years for the escrow should also be established.

IMPOUNDMENT

The last sentence of §13.1-510(h) allows the impounding of the proceeds of a "best efforts" underwriting until at least 75% of the registered securities have been sold. Only then are the funds so raised released to the issuing company. Impoundment basically helps to insure that a company will not invest inadequate amounts of capital in projects that are to be financed from the securities offering. The concept of impoundment is sound, although possibly the minimum percentage should be adjusted downward. The SCC should continue to be able to impound up to 100% of the proceeds from the sale of securities.

RECOMMENDATION: Used together, the concepts of escrow and impoundment may well provide an alternative to the dilution test the SCC now uses to evaluate stock pricing. This approach certainly needs more study and possibly some experimentation. Additionally, the escrow and impoundment concepts should not be limited to securities registered under the Qualification section, but should also be applied to securities registered under the Coordination section and if it is retained in the Securities Act, under the Notification section.

EXEMPTIONS (§13.1-514)

Various types of securities are exempted from registration under the Securities Act. Certain exemptions should be eliminated, however, because alternative control over the issuance of these exempted securities is weak or altogether absent.

-§13.1-514(a)(1) exempts, among other types of government securities, revenue obligations issued by local governments. Covered by this exemption are Industrial Development Authority Bonds issued to finance the construction of plants and facilities for profit making firms. Since these securities are not guaranteed by the municipality sponsoring the industrial development authority, their soundness is based solely on the financial condition and prospects of the company for whom the facility is being built. Buyers of these securities should have access to the same type of offering circular that they would receive were they considering the purchase of securities issued directly by the company.

RECOMMENDATION: Amend §13.1-514(a)(1) to specifically exclude from this exemption intrastate securities issued by Industrial Development Authorities. This would effectively require the registration of these securities under the Qualification section.

-13.1-514(a)(3) through (7). These exemptions apply to securities issued or guaranteed by various types of financial and transportation companies. While the government agencies regulating these firms generally do review and control the securities issued by these firms, there may be situations where certain securities issues, particularly those guaranteed by banks, savings and loans, or insurance companies, are not passed on by another regulatory body.

RECOMMENDATION: Amend subsections (3) to (7) of §13.1-514(a) to allow exemption from registration under the Securities Act only in those situations where the issuance of securities by these institutions is regulated by another government agency. Elsewise, the securities would have to be registered under the Qualification section.

-§13.1-514(a)(9) exempts from registration under the Securities Act securities issued by educational, religious, benevolent, charitable, and other types of non-profit institutions. The report, on page 5, admits that there is a problem with this exemption, but makes no recommendation other than that a comprehensive evaluation of it would be in order. In fact, there have been numerous instances of interest defaults and partial or total loss of principal with this type of security.

While many purchasers of these securities, particularly church bonds, do not expect to be repaid fully, the fact that these securities have to be offered at high interest rates in order to be sold, and that newspaper advertisements for these securities stress the high rate of return, indicates that many purchasers in fact do look upon these securities primarily or entirely as an income producing and principal repaying investment.

Since these securities are exempt from registration under both federal and state law, no regulatory agency reviews the prospectuses or offering circulars for these securities as to accuracy, misrepresentations, fullness of disclosure, financial soundness, etc. Because of the federal exemption, Virginia is legally flooded with unregistered, out-of-state offerings; something that does not occur with any other type of security.

These arguments are given for not requiring the registration of these securities:

(1) Existing registration requirements are not applicable to securities issued by non-profit organizations;
(2) These organizations should not be subject to heavy registration expenses; and
(3) Non-profits, because they non-profit, are less likely to be fraudulent schemes out to fleece investors.

These arguments do not hold up under examination:

(1) Generally accepted accounting principles, including the concept of depreciation, are just as applicable to non-profit institutions as to profit-making firms and the same tests of financial soundness can be applied to the non-profits' balance sheets, revenue and expense statements and statements of source and application of funds. Also, there is no reason why certified financial statements should not be required of these institutions since many of them now have them.

In determining whether or not a particular issue should be tagged as highly risky, particular attention should be given to the statement of source and application of funds to determine

whether or not the institution can reasonably be expected to generate the cash needed to meet the obligations it will incur through the sale of the securities.

(2) Registration expenses can be held down by striking a balance between the disclosure requirements, or lack thereof, that now exist and what is currently required for profit-making firms. Also, fuller disclosure might make the securities of the financially sounder non-profits more marketable, which, in turn, should result in lower interest costs and sales commissions and, possibly, a lower overall cost of raising capital.

(3) As experience has so often shown, man's willingness to defraud others is not limited solely to supposedly profit-making ventures. For that reason, proposed securities issues of the non-profits should be subject to the same review for potential fraud as is now the case for unexempted securities.

RECOMMENDATION: That §13.1-514 be amended by repealing subsection (a)(9). Replacing that subsection should be a new section of the Code dealing with the qualification of securities issued by the non-profit organizations delineated in subsection (a)(9). The new section should set out the requirements for registration and disclosure in regard to securities issued by these organizations. The sole exemption to this qualification section should be for those securities that are being sold directly to the institution's members and without the involvement of a professional broker or underwriter. For example, this would exempt securities sold by a church to bona fide members of its congregation or by a fraternal lodge to the members of that lodge. The General Assembly, through a resolution, should also memorialize Congress to amend the Federal Securities Act of 1933 to eliminate the exemption from registration that is presently enjoyed by non-profit institutions issuing securities on an interstate basis.

TRANSACTIONS EXEMPTED FROM REGISTRATION (§13.1-514(b))

§13.1-514(b)(8) provides for exempting private placements of securities from registration under the Securities Act. As is discussed on page 5 of the report, the Commonwealth's long run policy should be to conform Virginia's private placement law for intrastate placements with the SEC's proposed rule 146, which deals with the federal regulation of interstate private placements. I agree with the concept of federal-state conformity in this area, but I do not agree with the recommended course of action.

RECOMMENDATION: Virginia should repeal §13.1-514(b)(8) and replace it with a Code section that would incorporate by reference SEC rule 146, and future amendments thereto, subject to *subsequent* review by the General Assembly. This approach towards conformity would be similar to the approach of Virginia in conforming its state income tax laws to the federal income tax laws — unless specifically changed by the General Assembly, changes in federal law, or rules in this instance, would automatically become incorporated into Virginia law. This approach, as versus requiring *prior* approval by the General Assembly of any changes in Rule 146, would insure that Virginia would always be in conformity with the SEC in an area where, due to its complexity, federal-state conformity is desirable.

UNLAWFUL PRACTICES

CRIMINAL PROSECUTIONS

At present, local Commonwealth's Attorneys have the sole power to prosecute violations of the Securities Act. As was brought out in testimony before the commission, the Commonwealth's Attorneys are frequently slow to

move in prosecuting Securities Act violations because the securities law is complex and because they have little, if any, experience in trying such cases. On page 4 of the report is the recommendation that the Attorney General's office be empowered in securities cases to provide prosecution assistance to a Commonwealth's Attorney if he requests it. This recommendation is too weak because it still leaves the responsibility for obtaining indictments and trying securities cases with the local official.

RECOMMENDATION: That §2.1-124 be amended to allow the Attorney General, on his own initiative, to initiate and prosecute criminal actions against alleged violators of the Securities Act or, if he wishes, to provide advice and technical assistance to the local Commonwealth's Attorney if he feels that the local official can competently handle the case. Such a procedure would greatly strengthen the Commonwealth's hand in dealing with violators of the law who frequently operate across the state, if not in several states.

"BADGES OF FRAUD"

On page 4 of the report, the "badges of fraud" concept is raised during a discussion of the preliminary investigation of alleged violations of the Securities Act. Testimony before the Commission indicated that existing procedures did not allow the SCC to move fast enough to at least make an initial determination of whether or not a securities fraud was being perpetrated because of the slowness in which suspected violators produced their records. I very strongly second the Commission's recommendation to adopt the much faster and more aggressive "badges of fraud" concept in investigating complaints from the public. Hopefully, this more aggressive approach will enable the SCC to stop securities frauds sooner than has been the case in the past.

Bert Ely

March 1, 1974

APPENDIX I

The following statistics illustrate the volume of work being done by the Securities and Retail Franchising Division of the State Corporation Commission. They include the number of registrations for securities' issues, broker-dealers, agents and franchisors and also the number of investigations conducted by the Division.

REGISTRATION - 1971
JANUARY 1 - DECEMBER 31

	Coordination	*Notification*	*Qualification*	*Withdrawals*	
January	*47*	*3*	*0*	*0*	*3*
February	*52*	*0*	*1*	*2*	*1*
March	*70*	*4*	*6*	*4*	*2*
April	*98*	*1*	*5*	*7*	*1*
May	*86*	*2*	*3*	*6*	*91*
June	*89*	*0*	*4*	*15*	*5*
July	*86*	*0*	*6*	*12*	*0*
August	*77*	*2*	*5*	*10*	*1*
September	*83*	*3*	*4*	*9*	*7*
October	*120*	*4*	*2*	*10*	*2*
November	*80*	*2*	*8*	*17*	*7*
December	*64*	*0*	*3*	*13*	*0*
Total	*952*	*21*	*47*	*105**	120
Annual Fees Collected	*$67,254.34*	*$1,005.00*	*$9,258.50*	*($865.00)*	*$1,150.00*

* *Of the Withdrawals 6 were Qualification, 1 was Notification, 98 were Coordination*

REGISTRATION - 1972
JANUARY 1 - NOVEMBER 30

	Coordination	*Notification*	*Qualification*	*Withdrawals*	*Agents-of-the Issuer*
January	*80*	*3*	*2*	*6*	*3*
February	*87*	*1*	*4*	*10*	*2*
March	*115*	*2*	*5*	*8*	*1*
April	*123*	*2*	*2*	*11*	*1*
May	*153*	*2*	*5*	*14*	*107*
June	*115*	*3*	*4*	*14*	*67*
July	*106*	*0*	*2*	*6*	
August	*100*	*1*	*5*	*18*	*23*
September	*109*	*1*	*6*	*6*	*40*
October	*108*	*0*	*4*	*15*	
November	*73*	*2*	*4*	*12*	*10*
Total	*1,169*	*17*	*43*	*120**	*291*
Annual Fees Collected	*$81,880.70*	*$1,110.00*	*$7,255.50*	*($625.00)*	*$2,860.00*

* *Of the Withdrawals 7 were Qualification, 113 were Coordination*

REGISTRATION FOR BROKER-DEALERS

	Brokers-Dealers Registered	Brokers-Dealers Cancelled	Fees Collected
1971	217	46	$5,425.00
** 1972	188	17	$4,975.00

** These figures represent an eleven month period starting January 1, 1972 through November 30, 1972. The difference in Broker-Dealers registered and fees collected is a result of applications being denied and the fees not eing refundable.

REGISTRATION FOR AGENTS

	Agents Registered	Agents that Transferred and No Fee was Required	Fees Collected
1971	5794	23	$57,940.00
** 1972	6405	16	$63,890.00

** These figures represent an eleven month period from January 1, 1972 through November 30, 1972.

INVESTIGATIONS

	1971	*1972*
Broker-Dealer Examinations	92	70
Corporate Investigations	34	24
Complaints and Miscellaneous	20	21
Complaints vs. Broker-Dealers		2
TOTAL - November 22, 1972	146	117

REGISTRATIONS FOR FRANCHISORS

As of March 31, 1973	Franchisor Registrations	Fees Collected
	65	$1,625.00
	Franchisor's Denied	
	5	125.00
	Franchisor's Pending	
	3	75.00
TOTALS	73	$1,825.00

APPENDIX II

A BILL

To amend the Code of Virginia by adding in Article 5 of Chapter 5 of Title 13.1 a section numbered 13.1-520.1 and to further amend the Code of Virginia by adding in Chapter 5 of Title 13.1 an article numbered 6 containing sections numbered 13.1-527.1 through 13.1-527.3, relating respectively, to certain information to be transmitted to Commonwealth's Attorneys and creation of a Division of Securities Counsel in the office of the attorney general to assist in prosecution of violators of the Securities Act.

Be it enacted by the General Assembly of Virginia:

1. That the Code of Virginia be amended by adding a section numbered 13.1-520.1 and that the Code of Virginia be further amended by adding in Chapter 5 of Title 13.1 an article numbered 13.1-527.1 through 13.1-527.3.

§ 13.1-520.1. The commission may transmit the record of any proceeding or any complaint involving any violation of this act to the attorney for the Commonwealth in the county or city wherein the violation occurred.

Article 6

§ 13.1-527.1. There is hereby created in the office of the Attorney General a Division of Securities Counsel.

The duties of such Division shall be to provide legal and technical assistance to an attorney for the Commonwealth, in the preparation for a prosecution of and the prosecution of a violation of this act; provided, however, such assistance shall be rendered only upon the request of the attorney for the Commonwealth.

§ 13.1-527.2. The Attorney General may employ and fix the salaries of such attorneys, employees and consultants, within the amounts appropriated to the Attorney General for providing legal service for the State, as he may deem necessary in the operation of the Division of Securities Counsel to carry out its functions.

§ 13.1-527.3. The State Corporation Commission shall provide technical assistance to the Division of Securities Counsel in its investigation and preparation of a prosecution under the provisions of this act.

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A BILL

To amend and reenact §§ 13.1-501 as amended, 13.1-504, 13.1-505 and 13.1-506 of the Code of Virginia, relating to definitions under the Securities Act and the registration of broker-dealers and agents thereunder.

Be it enacted by the General Assembly of Virginia:

1. That §§ 13.1-501 as amended, 13.1-504, 13.1-505 and 13.1-506 of the Code of Virginia be amended and reenacted as follows:

§ **13.1-501. Definitions.** — When used in this chapter, unless the context otherwise requires:

(a) *"Commission"* means the State Corporation Commission of Virginia.

(b) *"Agent"* means any individual who, as a director, officer, partner, associate, employee or sales representative of a broker-dealer or issuer, effects or undertakes to effect sales of securities, otherwise than on behalf of an issuer offering a security exempted by clause (1), (2), (3), (7), (10) or (11) of § 13.1-514 (a).

(c) *"Broker-dealer"* means any person engaged in the business of selling securities for the account of others or for his own account otherwise than with or through a broker-dealer or agent, but does not include a bank, an issuer or an agent.

(d) *"Guaranteed"* means guaranteed as to payment of principal, interest or dividends.

(e) *"Issuer"* means any person who issues or proposes to issue a security, except that

(1) With respect to certificates of deposit, voting trust certificates or collateral trust certificates, and with respect to certificates of interest or shares in an unincorporated investment trust not having a board of directors (or persons performing similar functions) or of the fixed, restricted management or unit type, the term "issuer" means the person or persons performing the acts and assuming the duties of manager;

(2) With respect to equipment trust certificates or like securities "issuer" means the person by whom the equipment is or is to be used;

(3) With respect to oil, gas or other mineral leases, rights or royalties or interests therein, "issuer" means the owner of any such lease, right, royalty or interest (whether whole or fractional) who creates fractional interests therein for the purpose of offering to more than five persons.

(f) *"Nonissuer distribution"* means any transaction not directly or indirectly for the benefit of the issuer

(g) *"Person"* means an individual, a partnership, a corporation, an unincorporated association, a government, a subdivision of a government or a trust in which the interests of the beneficiaries are evidenced by securities.

(h) (1) The term *"sale"* or *"sell"* includes every contract of sale of, contract to sell, or disposition of, a security or interest in a security for value.

(2) The term *"offer"* includes every attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security for value.

(3) For the purposes of article 4 (§ 13.1-507 et seq.) of this chapter the terms defined in this subsection shall not include negotiations or agreements between the issuer and any underwriter or among underwriters; or any transaction by the pledgee of a security unless made directly or indirectly for the benefit of the issuer.

(4) Any security given or delivered with, or as a bonus on account of, any purchase of securities or any other thing shall be deemed to constitute

part of the subject of such purchase and to have been offered and sold for value.

(5) Every sale or offer of a warrant or right to purchase or subscribe to another security of the same issuer or of another person, and every sale or offer, of a security which gives the holder thereof a present or future right or privilege to convert such security into another security of the same issuer or of another person, shall be deemed to include an offer of such other security.

(i) *"Securities Act of 1933," "Securities Exchange Act of 1934"* and *"Investment Company Act of 1940"* mean the federal statutes of those names as now or hereafter amended.

(j) *"Security"* means any note; stock; treasury stock; bond; debenture; evidence of indebtedness; certificate of interest or participation in any profit sharing agreement; collateral trust certificate; preorganization certificate of subscription; transferable share; investment contract; voting-trust certificate; certificate of deposit for a security; oil, gas or other mineral lease, right or royalty, or any interest therein; or, in general, any interest or instrument commonly known as a "security," or any certificate of interest or participation in, temporary or interim certificate for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.

(k) *"State"* means any state, territory or possession of the United States, including the District of Columbia and Puerto Rico.

"Investment adviser" means any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities; but does not include (A) a bank, or any bank holding company as defined in the Bank Holding Company Act of 1956 which is not an investment company; (B) any lawyer, accountant, engineer, or teacher whose performance of such services is solely incidental to the practice of his profession; (C) any broker or dealer whose performance of such services is solely incidental to the conduct of his business as a broker or dealer and who receives no special compensation therefor; (D) the publisher of any bona fide newspaper, news magazine or business or financial publication of general and regular circulation; (E) any person whose advice, analyses, or reports relate to no securities other than securities which are direct obligations of or obligations guaranteed as to principal or interest by the United States, or securities issued or guaranteed by corporations in which the United States has a direct or indirect interest which shall have been designated by the Secretary of the Treasury, pursuant to section 78c(a) (12) of this title, as exempted securities for the purposes of the Securities Exchange Act of 1934; or (F) such other persons not within the intent of this paragraph, as the Commission may designate by rules and regulations or order.

§ 13.1-505. Procedure for registration. (a) A broker-dealer *investment advisor* or agent may be registered after filing with the Commission an application containing such relevant information as the Commission may require. He shall be registered if the Commission finds that he (and, in the case of a corporation or partnership, the officers, directors or partners) is a person of good character and reputation, that he has a regular place of business in this State, that his knowledge of the securities business and his financial responsibility are such that he is a suitable person to engage in the business, that he has supplied all information required by the Commission and that he has paid the necessary fee.

(b) The Commission may require as a condition of registration or renewal of registration the filing by a broker-dealer *or in-*

vestment advisor of a reasonable surety bond conditioned as the Commissioner may require for the protection of investors not in any case exceeding $25,000 in penalty amount as evidence of financial responsibility except that no bond shall be required where the net worth of the broker-dealer *or investment advisor* exceeds $25,000.

(c) The Commission may require as a condition of registration the passing of a written examination as evidence of knowledge of the securities business.

(d) All registrations and renewals thereof shall expire at midnight on the following thirtieth day of April.

(e) Upon application for a renewal of a registration the Commission shall have jurisdiction to determine, as of such time, the propriety of the renewal registration.

(f) Each application for a registration or renewal of a registration as a broker-dealer *or investment advisor* shall be accompanied by a fee of twenty-five dollars, payable to the Treasurer of Virginia. If the registration or renewal is not granted the application fee shall not be returnable.

(g) Each application for a registration or renewal of a registration as an agent shall be accompanied by a fee of ten dollars, payable to the Treasurer of Virginia. If the registration or renewal is not granted the application fee shall not be returnable.

(g) Each application for a registration or renewal of a registration as an agent shall be accompanied by a fee of ten dollars, payable to the Treasurer of Virginia. If the registration or renewal is not granted the application fee shall not be returnable.

(h) For the purposes of registration as a broker-dealer, a partnership shall be treated as the same partnership so long as two or more members of the partnership named in the application continue the business without change of location, if the partnership, within one month after a change in the partnership, files with the Commission a copy of a certificate filed in compliance with § 50-74.

(i) The Commission shall either grant or deny each application for registration within thirty days after it is filed but this period may be extended if additional time is required for formal hearing on the application.

(j) A renewal of registration shall be granted as of course upon receipt of the proper application and fee together with any surety bond that the Commission may pursuant to subsection (b) require unless the registration was, or the renewal would be, subject to revocation under § 13.1-506.

§ 13.1-506. Revocation of registration. The Commission may, by order entered after a hearing on notice duly served on the defendant not less than thirty days before the date of the hearing, revoke the registration of a broker-dealer *investment advisor* or agent (or refuse to renew a registration if an application for (renewal has been or is to be filed) if it finds that such an order is in the public interest and that such broker-dealer *investment advisor* or any partner, officer or director of such broker-dealer (or any person occupying a similar status or performing similar functions), or any person directly or indirectly controlling or controlled by such broker-dealer or that such agent:

(1) Has engaged in any fraudulent transaction;

(2) Is insolvent, or in danger of becoming insolvent, either

in the sense that his liabilities exceed his assets or in the sense that he cannot meet his obligations as they mature;

(3) Has been adjudicated mentally incompetent or is a person for whom a committee or guardian has been appointed and is acting;

(4) Has been convicted, within or without this State, of any misdemeanor involving a security or any aspect of the securities business or any felony;

(5) Has failed to furnish information requested by the Commission concerning his conduct of the securities business; or

(6) Has no regular place of business in this State.

#

A B I L L

To amend and reenact § 13.1-504 of the Code of Virginia relating to registration of broker-dealers and agents under the Securities Act.

Be it enacted by the General Assembly of Virginia:

1. That § 13.1-504 of the Code of Virginia is amended and reenacted as follows:

§ **13.1-504. Registration.** — (a) It shall be unlawful for any person to transact business in this State as a broker-dealer or as an agent, except in transactions exempted by § 13.1-514 (b), unless he is so registered under this chapter.

(b) The registration of an agent shall be deemed effective only so long as he is connected with a specified broker-dealer registered under this chapter or a specified issuer. When an agent begins or terminates a connection with a broker-dealer or issuer, both the agent and the broker-dealer or issuer shall promptly notify the Commission. An agent who changes his connection from one broker-dealer or issuer to another shall not be required to file a new application for registration. It shall be unlawful for any broker-dealer or issuer to employ an unregistered agent. ~~More than one broker dealer or issuer may employ the same agent~~. *No agent shall be employed by more than one broker-dealer or issuer.*

#

A BILL

To amend and reenact § 13.1-505 of the Code of Virginia relating to registration procedure for broker-dealers and agents.

Be it enacted by the General Assembly of Virginia:

1. That § 13.1-505 of the Code of Virginia is amended and reenacted as follows:

§ **13.1-505. Procedure for registration.** — (a) A broker-dealer or agent may be registered after filing with the Commission an application containing such relevant information as the Commission may require. He shall be registered if the Commission finds that he (and, in the case of a corporation or partnership, the officers, directors or partners) is a person of good character and reputation, that he has a regular place of business in this State, that his knowledge of the securities business and his financial responsibility are such that he is a suitable person to engage in the business, that he has supplied all information required by the Commission and that he has paid the necessary fee.

(b) The Commission may require as a condition of registration or renewal of registration the filing by a broker-dealer of a reasonable surety bond conditioned as the Commissioner may require for the protection of investors not in any case exceeding $25,000 in penalty amount as evidence of financial responsibility except that no bond shall be required where the net worth of the broker-dealer exceeds $25,000.

(c) The Commission may require as a condition of registration the passing of a written examination as evidence of knowledge of the securities business.

(d) All registrations and renewals thereof shall expire ~~at midnight on the following thirtieth day of April~~ *annually in accordance with rules and regulations promulgated by the Commission.*

(e) Upon application for a renewal of a registration the Commission shall have jurisdiction to determine, as of such time, the propriety of the renewal registration.

(f) Each application for a registration or renewal of a registration as a broker-dealer shall be accompanied by a fee of twenty-five dollars, payable to the Treasurer of Virginia. If the registration or renewal is not granted the application fee shall not be returnable.

(g) Each application for a registration or renewal of a registration as an agent shall be accompanied by a fee of ten dollars, payable to the Treasurer of Virginia. If the registration or renewal is not granted the application fee shall not be returnable.

(h) For the purposes of registration as a broker-dealer, a partnership shall be treated as the same partnership so long as two or more members of the partnership named in the application continue the business without change of location, if the partnership, within one month after a change in the partnership, files with the Commission a copy of a certificate filed in compliance with § 50-74.

(i) The Commission shall either grant or deny each application for registration within thirty days after it is filed but this period may be extended if additional time is required for formal hearing on the application.

(j) A renewal of registration shall be granted as of course upon receipt of the proper application and fee together with any surety bond that the Commission may pursuant to subsection (b) require unless the registration was, or the renewal would be, subject to revocation under § 13.1-506.

#

A BILL

To amend the Code of Virginia by adding a section numbered 13.1-518.1 providing for filing of certain reports with the State Corporation Commission.

Be it enacted by the General Assembly of Virginia:

1. That the Code of Virginia is amended by adding a section numbered 13.1-518.1 as follows:

§ 13.1-518.1. Every broker-dealer registered in the Commonwealth shall be required to file all reports made by such broker-dealers and all reports of audits of such broker-dealers by the National Association of Security Dealers, the Securities and Exchange Commission and any national stock exchange with the State Corporation Commission within ten days of the publication of such report or audit.

#

A BILL

To amend and reenact § 13.1-514, as amended, of the Code of Virginia relating to exemptions from registration.

Be it enacted by the General Assembly of Virginia:

1. That § 13.1-514, as amended, of the Code of Virginia is amended and reenacted as follows:

§ **13.1-514. Exemptions.** — (a) The following securities are exempted from the securities registration requirements of this chapter:

(1) Any security (including a revenue obligation) issued or guaranteed by the United States, any state, any political subdivision of a state or any agency or corporate or other instrumentality of one or more of the foregoing; or any certificate of deposit for any of the foregoing;

(2) Any security issued or guaranteed by Canada, any Canadian province, any political subdivision of any such province, any agency or corporate or other instrumentality of one or more of the foregoing or any other foreign government with which the United States currently maintains diplomatic relations, if the security is recognized as a valid obligation by such issuer or guarantor;

(3) Any security issued by and representing an interest in or a debt of, or guaranteed by, the International Bank for Reconstruction and Development, or any national bank, or any bank or trust company organized under the laws of any state and supervised by the banking commissioner or similar official of that state or this State;

(4) Any security issued by and representing an interest in or a debt of, or guaranteed by, any federal building and loan association, or by any building and loan association which is organized under the laws of this State and is supervised and examined by the Commission;

(5) Any security issued or guaranteed by an insurance company licensed to transact insurance business in this State, or the sale of whose stock has been licensed pursuant to § 38.1-123;

(6) Any security issued by any credit union or industrial loan association which is organized under the laws of this State and is supervised and examined by the Commission;

(7) Any security issued or guaranteed by any railroad, other common carrier or public service company supervised as to its rates and the issuance of its securities by a governmental authority of the United States, any state, Canada or any Canadian province;

(8) Any security which is listed or approved for listing upon notice of issuance on the New York Stock Exchange, the American Stock Exchange or the Midwest Stock Exchange ~~or which is listed on the Richmond Stock Exchange~~; any other security of the same issuer which is of senior or substantially equal rank; any security called for by subscription rights or warrants admitted to trading in any of said exchanges; or any warrant or right to subscribe to any of the foregoing securities;

(9) Any security issued by any person organized and operated not for private profit but exclusively for religious, educational, benevolent, charitable, fraternal, social, athletic or reformatory purposes, or as a chamber of commerce or trade or professional association;

(10) Any commercial paper which arises out of a current transaction or the proceeds of which have been or are to be used for current transactions, and which evidences an obligation to pay cash within nine months after the date of issuance, exclusive of days of grace, or any renewal thereof which is likewise limited, or any guaranty of such paper or of any such renewal;

(11) Any security issued in connection with an employees' stock purchase, savings, pension, profit-sharing or similar benefit plan;

(12) Any security issued by a cooperative association organized as a corporation under the laws of this State.

(13) Any security listed on an exchange registered with the United States Securities and Exchange Commission and approved by regulations of the State Corporation Commission.

(b) The following transactions are exempted from the securities registration and the broker-dealer registration requirements of this chapter except as in this subsection expressly provided:

(1) Any isolated transaction by the owner or pledgee of a security, whether effected through a broker-dealer or not, which is not directly or indirectly for the benefit of the issuer;

(2) Any nonissuer distribution by a registered broker-dealer of a security if information regarding the issuer of such security is included in one or more of the standard securities manuals in general use;

(3) Any nonissuer distribution by a registered broker-dealer of a security that has been outstanding in the hands of the public for the past five years, if the issuer in each of the past three fiscal years has lawfully paid dividends on its common stock aggregating at least four percent of its current market price;

(4) Any transaction by a registered broker-dealer pursuant to an unsolicited order or offer to buy;

(5) Any transaction in a bond or other evidence of indebtedness secured by a real or chattel mortgage or deed of trust or by an agreement for the sale of real estate or chattels, if the entire indebtedness secured thereby is offered and sold as a unit;

(6) Any transaction in his official capacity by a reciever, trustee in bankruptcy or other judicially appointed officer selling securities pursuant to court order;

(7) Any offer or sale to a corporation, investment company or pension or profit-sharing trust or to a broker-dealer;

(8) Any sale of its securities by an issuer if, after the sale, it has not more than thirty security holders, and if its securities have not been offered to the general public by advertisement or solicitation. The number of security holders of a corporation shall be deemed to include the security holders of any other corporation that was organized to raise capital for it. Notwithstanding the provisions of subsection (c) (2), the merger or consolidation of corporations shall be a violation of this chapter if the surviving or new corporation has more than thirty security holders and all the securities of the parties thereto were issued under this exemption, unless all of the parties thereto have been engaged in transacting business for more than two years prior to the merger or consolidation;

(9) Any transaction pursuant to an offer to existing security holders of the issuer including holders of transferable warrants issued to existing security holders and exercisable within ninety days of their issuance, if either (A) no commission or other remuneration (other than a standby commission) is paid or given directly or indirectly for soliciting any security holder in this State, or (B) the issuer first notifies the Commission in writing of the terms of the offer and the Commission does not by order disallow the exemption within five full business days after the date of the receipt of the notice;

(10) Any offer (but not a sale) of a security for which registration statements have been filed under both this chapter and the Securities Act of 1933; but this exemption shall not apply while a stop order is in effect or, after notice to the issuer, while a proceeding or examination looking toward such an order is pending under either act;

(11) The issuance of not more than three shares of common stock to

one or more of the incorporators of a corporation and the initial transfer thereof.

(12) Sales of an issue of bonds, aggregating seventy-five thousand dollars or less, secured by a first lien deed of trust on realty situated in Virginia, to fifteen persons or less who are residents of Virginia.

(c) The following transactions are exempted from all the provisions of this chapter:

(1) The issuance of any stock dividend, whether the corporation distributing the dividend is the issuer of the stock or not, if nothing of value is given by stockholders for the distribution other than the surrender of a right to a cash dividend where the stockholder can elect to take a dividend in cash or stock;

(2) Any transaction incident to a right of conversion or a statutory or judicially approved reclassification, recapitalization, reorganization, quasi-reorganization, stock split, reverse stock split, merger, consolidation or sale of assets.

(d) In any proceeding under this chapter, the burden of proving an exemption shall be upon the person claiming it.

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